Section 678

Estate Planning with Section 678 of the Internal Revenue Code : Part One

A review of the drafting options available to preserve asset protection, estate tax protection and divorce protection for trust beneficiaries, along with general protection for young and/or spendthrift beneficiaries, by avoiding the need to distribute income and capital gains in order to avoid the effects of compressed trust federal income tax brackets.

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As a child, the reader will remember being taught that, win or lose, after every baseball or soccer game we were to cheer for the opposing team: "2-4-6-8, who do we appreciate?" And then fill in the cheer with the opponent's team name. Today, *only a few years later*, the author is now most often heard to cheer: "Who do we appreciate? It's Congress and the Internal Revenue Code, **Section 678** !"

Why is **Section 678** so important in estate planning? The story actually beings in the year 1993, when

Congress saw fit to lower the amount at which trusts are taxed at the highest federal income tax rate to only $7,500 (inflation adjusted to $13,451, today). Thus, a trust established for the benefit of a decedent's minor child or children is taxed at the maximum federal income tax rate at only $13,451 of taxable income, and is entitled to only a $100 exemption for standard "complex trusts."

By comparison purposes, a single individual would need to have taxable income in excess of $539,000 before he or she would be in the maximum federal income tax bracket, after a standard deduction of $12,950. Added together, this means that an individual would need to have almost 41 times as much income as a trust, before he or she would be taxed in the same tax bracket.

Just three years later, in 1996, Congress decided it would tax S corporation interests held in so-called "Electing Small Business Trusts" (ESBTs) even less favorably than trusts for minor children, by imposing the maximum federal income tax rate on the trust's portion of the S corporation's income, regardless of the income level of the trust.

Finally, in 2019, Congress passed the SECURE Act (the focus of the second part of this article), which Act generally accelerates the income taxation on IRA and 401k plan benefits payable to trusts or individuals other than the surviving spouse, from a period formerly equal to the lifetime of the individual or trust income beneficiary, to a compressed period of only 10 years. Combined with the 1993 severe compression of trust income tax brackets when compared to individual income tax brackets, at first blush Congress in 2019 essentially eliminated the payment of IRA and 401k plan proceeds to trusts as an estate planning technique.

Even in high net worth situations, without additional planning it would make little sense today to pay IRA and 401k plan benefits to trusts, at least trusts which are designed to be exempt

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from transfer tax at the beneficiary's death, because the value of the transfer-tax-exempt trust would be reduced by the significant income tax burden on the IRA and 401k plan benefits.

Similar larger tax gaps between trusts and individuals exist in the case of the 15% and 20% capital gain rates, the latter coming into play at taxable income of as little as $13,701 for a trust (in 2022), while the 2022 comparable level for unmarried individuals is $459,750. Trusts also pay the 3.8% net investment income tax on the lesser of undistributed net investment income or adjusted gross income in excess of $13,451 (for 2022), whereas an unmarried individual needs to have net investment income or modified adjusted gross income in excess of $200,000 before they will need to pay the 3.8% tax.

In summary, over the last 30 years Congress has taken a variety of steps which, whether intended or not, appear to dampen enthusiasm for using trusts in estate planning, trusts which would otherwise help minimize transfer taxes when the life beneficiary passes, protect the lifetime beneficiary in cases of minority, incapacity or immaturity, and insulate the trust assets from claims against the beneficiary by creditors or a divorced spouse.

How Can Section 678 Help?

It would be a simple matter to distribute all of the current income of the trust to the trust beneficiaries, in order to avoid the compressed trust income tax rates. In limited circumstances (e.g., by allocating capital gains to trust accounting income in the trust document), it might also be possible to distribute the trust's capital gains to the beneficiaries, in order to avoid the higher capital gains rates typically applicable to trusts, as well as the 3.8% net investment income tax.

The problem is that few clients want these automatic trust distributions to their children or other heirs to occur. For the parents of minors and other young children and adults, the issue is obvious. Parents of young children and adults do not want significant automatic annual distributions to the children, or to the guardian or conservator for the children, to be made. Parents of older children are more concerned with issues of divorce protection, creditor protection, and estate tax minimization (including state death taxes) for their children.

The automatic distribution of trust income and capital gains to the children undermines this legitimate parental concern. Parents of special needs children also obviously do not want the trust income to be paid to the children.

Drafting Solutions

Here are some planning thoughts which the attorney or other advisor may wish to consider to assist clients in responding to their predicament - the challenge of achieving significant income tax savings while also preserving the non-tax purposes of the trust.

Use of Section 678 Withdrawal Power Over Trust Income.

For new trusts, drafting a **Section 678(a)(1)** withdrawal power over trust accounting income into the trust (other than a simple trust), in order to tax the trust beneficiary on all trust taxable income, is not only permissible in the tax law, but, for all the income-tax-saving reasons outlined above, is usually advisable. [1]

This withdrawal power should be coupled with a power in the trustee to allocate capital gains and IRA receipts, etc. to trust accounting income pursuant to a reasonable and impartial (i.e., with respect to current and remainder beneficiaries, including permissible appointees and takers in default of appointment) exercise of a discretionary power in the governing instrument, factoring in tax consequences to the trust and its beneficiaries. [2] Inclusion of the "reasonable and impartial" standard (which is actually already a part of most states' "duty of impartiality" for trustees) should forestall an IRS argument that a trustee-beneficiary possesses a general power of appointment over the entirety of the

IRA accounts, etc. and the appreciation portion of the securities as a result of the withdrawal power over trust accounting income.

The withdrawal power should also include a power in the trustee to fully or partially suspend the beneficiary's future withdrawal power in appropriate situations, e.g., immature or unwise use of withdrawn funds by the beneficiary, lawsuits, divorce, college financial aid qualification reasons, or, as discussed below, for the purpose of minimizing overall income taxes to the trust and its beneficiaries.

Except in the case where IRAs, etc., are distributable to the trust (which situation will be discussed in Part Two of this article), it may even be possible, and make sense in some circumstances, to add a **Section 678** withdrawal power to a "special" or "supplemental" needs trust, e.g., by giving the withdrawal power to a sibling or siblings in a modest income tax bracket. If so, the sibling's withdrawal power would again want to be coupled with an ability in the trustee to suspend the same, if the sibling is not acting in the special needs child's best interests. (See the additional discussion on trustee suspension powers, below.)

Note that if the withdrawal power holder needs funds to pay the income tax attributable to his or withdrawal

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right, he or she merely may exercise the withdrawal power to the extent so necessary. An alternative would be to allow an independent trustee to pay these taxes, either directly or indirectly by reimbursing the beneficiary.

Some may argue that a minor's legal guardian has a fiduciary duty to exercise the **Section 678** withdrawal power on behalf of the ward/beneficiary, and that therefore employment of the power of withdrawal in the case of minor beneficiaries could turn out to defeat the parents' desire that their children do not receive substantial sums at age 18. Is this a sound argument? Would a legal guardian, knowing that any amounts not withdrawn on the beneficiary's behalf will remain in a creditor-protected trust held exclusively for the ward's benefit, and that the ward will eventually control this trust at a designated age, be acting in the ward's best interest if he or she chose to exercise the withdrawal power and deposit the withdrawn funds in an unprotected guardianship or conservatorship account for the ward?

Assume the ward is later involved in a major car accident, and the guardianship or conservatorship estate is exhausted to satisfy a claim against the ward. Could the guardian then be surcharged for foolishly and needlessly withdrawing the funds from the protected trust? The point is self-evident. Regardless, as discussed in the immediately below section titled "Use of Trustee Suspension Power," the trustee could merely threaten to suspend the beneficiary's withdrawal power should the trustee determine the exercise of the same by a guardian acting on behalf of a minor would needlessly expose the protected trust assets to lawsuits.

Some may also argue that, under **Section 678(a)(2)** and IRS private letter rulings, when the beneficiary's withdrawal power lapses each year, the beneficiary continues to be taxed on an ever-increasing portion of the trust's income, including capital gains. The problem with this argument (aside from the fact that it is really just an argument in favor of lower income taxes, in most instances) is that it flies in the face of the Internal Revenue Code itself, as the withdrawal power holder has not "partially released or otherwise modified" the power. The power lapses by the terms of the trust, not by any affirmative "release" or "modification" on the part of the beneficiary withdrawal power holder, which is what **Section 678(a)(2)** requires. In any event, because it is now normally desired that all of the trust's taxable income be taxable to the current beneficiary anyway, this debate is largely of no consequence.

Because the beneficiary's withdrawal right is designed to fully or partially (i.e., subject to a "hanging power") lapse at the end of each year, i.e., to the extent of 5% of the value of the trust each year, in order to avoid annual taxable gifts under **Section 2514(e)** , will the lapsed amount be accessible to the beneficiary's future creditors? In most states, and under the Uniform Trust Code, the beneficiary's annual withdrawal power (including, presumably, any "hanging power") is not protected, but the annual lapses of the withdrawal rights, are. **3** In the balance of the states which do not protect the annual lapse of the withdrawal right from the beneficiary's creditors the question must be asked: Who is the real "creditor" here, when the alternative to " **Section 678** planning" is to pay much higher income taxes to the IRS? While the beneficiaries of a trust can protect themselves against many types of potential future lawsuits with umbrella liability insurance, these policies will obviously be ineffective as against the excessive income taxes the trust will most certainly owe the IRS.

Use of Trustee Suspension Power.

With the current and future uncertainty in the tax law, with the uncertainty in the trust's and beneficiary's respective tax situations, and with the above-described varied treatment of the **Section 678** withdrawal power for creditor rights purposes, the **Section 678** power needs to be drafted in a flexible fashion, so that it can adapt to various and changing circumstances. One way of accomplishing this is to allow an independent trustee the opportunity to annually suspend (and restore) future withdrawal powers, in whole or in part, prior to January 1 of the next tax year.

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Another reason for the needed flexibility is the manner in which certain trust expenses are treated for trust versus individual income tax purposes. The unbundled portion of trustee fees not attributable to investment advisory services, for example, may be deductible for trust income tax purposes, under the current tax law, but not deductible for individual income tax purposes. Under the IRS Regulations, an allocable portion of these types of fees would be applied to the beneficiary of the **Section 678** withdrawal power, and as a consequence would no longer be deductible. **4** The trustee may thus find itself in a situation where the federal marginal income tax rate applicable to the individual beneficiary is much lower than the federal marginal income tax rate applicable to the trust, but making use of the individual's income tax rate would eliminate a potentially significant annual income tax deduction.

Take, for example, a $2 million trust with a 1% annual trustee fee on the first $1 million of assets and a 0.75% fee on the next million. The total annual trustee fee would be $17,500. Assume also that no portion of this fee is allocable to tax-exempt income. If the deduction for this fee is lost by allocating it to the individual beneficiary under a **Section 678** power, the negative annual income tax effect could be as much as $6,500. If the individual beneficiary is at least that much ahead by having the trust income and capital gains taxed to him or her, versus the trust, this may be fine; but if the overall savings is less than this, suspension of the beneficiary's **Section 678** withdrawal power by an independent trustee may be in order. In many cases this will be easy enough to do, because the trust would likely already have an independent trustee in place. Note also that, after the suspension, the independent trustee will still retain the power to make **Sections 661** and **662** distributions to the individual beneficiary with the "after tax deduction income," the negative, of course, being the loss of the non-tax advantages for retaining assets in trust.

Suspension of the individual beneficiary's future withdrawal powers may likewise be advantageous when the trust would otherwise be entitled to a significant tax deduction for state taxes paid (if state capital gains taxes would otherwise be payable by the trust as a result of a large capital gain inside the trust), at a time when the individual beneficiary is already benefitting from a similar state tax deduction. Suspending the individual beneficiary's future **Section 678** withdrawal power may make it possible to, in effect, "double up" on the current $10,000 annual ceiling on the state income tax deduction and achieve an aggregate deduction of as much as $20,000. As in the case of the trustee fee deduction, this technique could then be coupled with a **Sections 661** and **662** distribution to the individual beneficiary of the "after tax deduction income." Again, the aggregate tax savings of using the suspension power in this situation should be balanced against the non-tax reasons for retaining the income in the trust. Note too that, under the trustee standard for determining trust accounting income as described, the trustee need not allocate all capital gains and IRA, etc. receipts to withdrawable trust accounting income, thus leaving some of this gross income in the trust to absorb "trust only" deductions. Under either planning technique, remember that the grantor trust "portion rules" under **Reg. 1.671-3** do not allow for a dollar-for-dollar tax deduction by the trust; a portion of the deductions will be allocated to the beneficiary and not be deductible on the trust tax return, in any event.

Suspension of the individual beneficiary's future **Section 678** withdrawal power may also make sense if the individual beneficiary is already in a high tax bracket, or if the individual beneficiary is subject to the so-called "Kiddie Tax" in a particular year. However, before making this decision, the independent trustee should bear in mind that this type of individual beneficiary might also be benefiting on the estate tax side, by personally paying the income taxes attributable to an estate or generation-skipping transfer tax exempt trust's income. If the decision to suspend is made here, remember that the independent trustee can always restore the beneficiary's withdrawal power in the future, in full or in part, if and when changed circumstances dictate.

In certain situations it may make sense for an independent trustee to only partially suspend a beneficiary's future **Section 678** withdrawal power. For example, if the trust does not have any significant tax deductions which would be lost, it might be beneficial to suspend the beneficiary's withdrawal power only over an amount equal to the level at which the trust reaches the maximum income tax bracket (e.g., $13,451 in 2022), or to some other lower tax bracket level. In so doing, the trustee may also elect to limit the suspension to income items other than qualified dividends and capital gains, first, so that the beneficiary may avail themselves of the significantly larger 0% tax bracket amount for these items, while also avoiding the 3.8% tax on net investment income.

Bear in mind, however, that the tax benefits of this "partial"

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suspension will be limited by the fact that the general effective tax rate on the compressed lower brackets of the trust is over 24%, a rate which does not kick in for single individuals until income levels of almost $102,026 (in 2022, including the $12,950 standard deduction). **5** The next tax bracket of 32% is not reached until the single individual has over $183,000 in income, including the $12,950 standard deduction. **6** Thus, unless the beneficiary has a significant taxable income, utilizing this partial suspension technique will normally be tax neutral, at best. In fact, and as alluded to above, subject to the potential application of the Kiddie Tax rules, if the beneficiary has little or no separate income, utilizing the suspension technique may effectively cause some loss of the 0% tax rate on qualified dividends and capital gains to a single beneficiary with income (including the $12,950 standard deduction) of $54,625 or less, in 2022.

As alluded to above, perhaps the most important reason for including a trustee suspension power in the trust is that it allows the trustee to maintain some control over the beneficiary's "non- tax situation." This is what concerns parents the most. As just some of the potential examples, the trustee might suspend the beneficiary's future withdrawal power (i) because of the immature or unwise use of funds the beneficiary is withdrawing from the trust, (ii) to motivate the beneficiary to take a particular action (e.g., go to college, or get a job), (iii) because the beneficiary is getting a divorce, (iv) because the beneficiary is involved in a lawsuit, or (v) because the beneficiary is attempting to qualify for college financial aid and a withdrawal right would hinder these efforts.

Due to the multitude and potential complexity of the issues involved, the trust document should exonerate the independent trustee for any decision or non-decision relative to the trustee's suspension power. The trustee should also be reminded that, in order to clearly comply with the **Section 678(a)(1)** requirements, the suspension power may only be exercised effective January 1 of the following tax year. This will typically require some level of annual dialogue between or among the trust's CPA, attorney, trustee, and/or investment advisor.

Trust Income Which Exceeds the Section 2514(e) Limitation

Assume that a significant portion of the trust accounting income (including capital gains and IRA, etc., receipts allocated to trust accounting income) would exceed the **Section 2514(e)** 5% limitation. Is there a solution to this problem which will cause the beneficiary to be taxed on the income, but without the potential of causing a taxable lapse under either **Section 2041(b)(2)** or **Section 2514(e)** ?

There is a 9th Circuit Court of Appeals decision, *Fish v. United States*, which, although incorrectly decided, nevertheless stands for the proposition that the "5 and 5" limitation in the case of a beneficiary's withdrawal power over income can only be based on the current income of the trust as the denominator. **7** It cannot be based on the entire value of the trust, even if the trustee is expressly granted the power, under the trust instrument, to use any assets of the trust in order to satisfy the beneficiary's exercise of the withdrawal power. The court's theory was that, because the beneficiary possessed no withdrawal power over trust principal, the latter could not be included in the "5% denominator," despite the clear language of the Internal Revenue Code to the contrary if the trustee was permitted to use any asset of the trust to satisfy the exercise of the beneficiary's withdrawal power.

Therefore, if wishing to avoid the 9th Circuit's holding in *Fish*, and simultaneously cause all of the trust's current income (including capital gains and IRA, etc., distributions) to be taxed to the trust's beneficiary, and not to the trust, one must utilize the following three-step process:

Step 1: Provide in the trust document that the trust's current beneficiary has a right to withdraw all of the "current income" of the trust, including, as defined in the trust document, all or a portion of the trust's capital gains and IRA, etc., distributions.

Step 2: Provide in the trust document that the beneficiary's withdrawal power over this trust income lapses at the end of each year, but only to the extent it will not constitute a release under either **Section 2041(b)(2)** or **Section 2514(e)** , and make clear in the trust document that the trustee can use any of the trust's assets, whether current income or principal, to satisfy the exercise of the withdrawal power by the beneficiary, including assets which may be payable to the trust over time, such as IRAs. **8** Because of the hanging power, even if *Fish* applied there would be no **Section 2041(b)(2)** or **Section 2514(e)** lapse issue.

Step 3: The current income not withdrawn by the beneficiary during the calendar year is added to the principal of the trust, and the current beneficiary retains an annual power to withdraw from the principal of the trust an amount equal to the trust's previous current income in which the beneficiary's withdrawal power did not lapse at the end of any previous calendar year pursuant to Step 2. This subsequent power of withdrawal over principal will thereupon lapse at the end of each succeeding calendar year, but again only to the extent it will

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not constitute a release under either **Section 2041(b)(2)** or **Section 2514(e)** . The trustee is given the power to use all or any portion of the trust's assets to satisfy the exercise of the withdrawal power by the beneficiary under this Step 3, other than current trust accounting income, including assets which may be payable to the trust over time, such as IRAs. Because the trust document now clearly bestows upon the beneficiary a right to withdraw trust principal in Step 3, the basis of the 9th Circuit's decision in *Fish* no longer exists.

If the beneficiary desires to accelerate the lapsing process under this 3-step plan, but without adding to the value of the beneficiary's assets, the beneficiary need merely exercise the beneficiary's power of withdrawal to pay the income taxes attributable to the **Section 678** power and/or to pay other living expenses. See Exhibit 1 for a sample form which implements these " **Section 678** " drafting recommendations.

In some situations the planner will envision trust income which may significantly exceed 5% per year, and that therefore there might be a significant estate tax inclusion amount at the beneficiary's death. In these situations the planner may either (i) opt not to allocate as much to trust accounting income each year and/or (ii) add additional **Section 678** withdrawal powers to the trust, e.g., in the beneficiary's children, in order to effectively increase the percentage each year which will not be subject to the beneficiary's hanging powers and potentially lower overall income taxes even further, i.e., depending upon the additional beneficiaries' income tax situations. The additional clauses illustrated in Exhibit 2 are designed to potentially achieve income tax basis step-up on the remaining assets of the trust at the death of the beneficiary, while also minimizing estate and generation-skipping transfer taxes.

In attempting to achieve an optimum income tax basis step-up level when the beneficiary has a spouse, the independent trustee or testator must first recognize that, to the extent the independent trustee adds a general testamentary power of appointment to, or the testator triggers the Delaware Tax Trap over, an accumulation trust having a zero inclusion ratio, and as a result assets are appointed in favor of the testator's descendants and/or a bypass trust for the benefit of the testator's surviving spouse and/or descendants (i.e., rather than to the surviving spouse and/or a QTIP Trust for the benefit of the surviving spouse where the QTIP election is made), this action will reduce the availability of the portability election to the surviving spouse.

Thus, should the surviving spouse have a significant estate of his or her own, including property which was acquired from the testator and property which was jointly-owned with the testator, federal and state estate taxes may be owed by the surviving spouse's estate which would not have been owed had the portability election been preserved by not intentionally causing estate tax inclusion solely for income tax basis purposes. Appointing the trust assets to the surviving spouse and/or to a QTIP trust for the surviving spouse will create income tax basis without disturbing the availability of the portability election, but of course at the expense of increasing the size of the surviving spouse's taxable estate.

In the case of a bypass trust, including one which receives IRA or qualified retirement plan benefits, the drafting attorney may want to consider placing a limit on the surviving spouse's conditional testamentary general

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power of appointment if generation-skipping planning is involved. This is because the deceased spouse's generation-skipping transfer tax exemption is not portable. Thus, for example, if (i) the estate tax exemption available to the surviving spouse is $9 million, as a result of combining $3 million of estate tax exemption from the deceased spouse, but the surviving spouse's generation-skipping transfer tax exemption is only $6 million, (ii) the surviving spouse's gross estate is valued at $6 million, and (iii) the bypass trust assets are worth $6 million, would it make sense to grant the surviving spouse a conditional general testamentary power of appointment over $3 million of the bypass trust's assets, in order to achieve income tax basis step-up at the surviving spouse's death, but in the process eliminate the GST-exempt nature of the bypass trust assets? Some may argue that the answer is no, despite the income tax basis step-up potential, especially if it is anticipated that the trustee of the bypass trust will trade regularly. If this is the planner's philosophy, the following additional pullback "(v)" can be added to the form in Exhibit 2 in the case of a beneficiary who is a surviving spouse: "the trust assets losing their inclusion ratio, as defined in **Section 2642(a) of the Internal Revenue Code** , or any successor section thereto, of zero, assuming the maximum allocation of the surviving spouse's exemption under **Section 2631(a) of the Internal Revenue Code** , or any successor section thereto, to said assets and to all other assets eligible to have the same exemption allocated to them at the surviving spouse's death."

Exhibit 1. Section 1 . Distribution of Income and Principal During Lifetime of Beneficiary

1.1 Subject to the remaining provisions of this subsection 1.1, during the beneficiary's lifetime the beneficiary (including any legal representative acting on behalf of the beneficiary if the beneficiary is under a legal incapacity) shall have the annual noncumulative power to withdraw all or any portion of the trust accounting income on or before December 31 of the calendar year (or on the date of the beneficiary's death, if earlier); PROVIDED, HOWEVER, that (i) the foregoing power of withdrawal shall not extend to the portion of the trust accounting income which, for the calendar year, would be exempt from federal income tax, and (ii) if Section 2041(b)(2) and/or 2514(e) of the Internal Revenue Code, or any successor sections thereto, is/are in effect during the calendar year, the beneficiary's power of withdrawal under this subsection 1.1 shall lapse at the end of the calendar year (or on the date of the beneficiary's death, if earlier) to the extent the same shall not constitute a release of a general power of appointment by the beneficiary pursuant to the provisions of either or both Section 2041(b)(2) and/or 2514(e) of the Internal Revenue Code, or any successor sections thereto in effect at the time of the lapse, after factoring in all other lapsed powers of withdrawal of the beneficiary other than pursuant to the provisions of subsection 1.2, below. The portion of the trust accounting income for the calendar year subject to the beneficiary's foregoing power of withdrawal which is not withdrawn by the beneficiary (including by any legal representative acting on behalf of the beneficiary if the beneficiary is under a legal incapacity) during the calendar year and in which the beneficiary's withdrawal power has not lapsed pursuant to the foregoing provisions of this subsection 1.1 shall accumulate and continue to be subject to a power of withdrawal in the beneficiary (including any legal representative acting on behalf of the beneficiary if the beneficiary is under a legal incapacity) pursuant to the provisions of subsection 1.2, below. Any such withdrawable trust accounting income which is not withdrawn by the beneficiary (or by a legal representative acting on behalf of the beneficiary if the beneficiary is under a legal disability) by the end of any calendar year (or by the time of the beneficiary's death, if earlier) shall be added to the principal of the trust estate. [ATTORNEY DRAFTING NOTE: MAY NOT WANT TO USE BENEFICIARY INCOME WITHDRAWAL RIGHTS WHEN: (1) SECOND SPOUSE, OR (2) HIGH NET WORTH CLIENT AND NO TAX BENEFIT FOR SUCH POWER OVER NON-GST TAX-EXEMPT TRUST.]

1.2 Subject to the remaining provisions of this subsection 1.2, during the beneficiary's lifetime the beneficiary (including any legal representative acting on behalf of the beneficiary if the beneficiary is under a legal incapacity) shall have the annual power to withdraw from the principal of the trust estate an amount equal to all or any portion of the trust accounting income for all previous years of the trust which has not previously been withdrawn by the beneficiary (either pursuant to the provisions of subsection 1.1, above, or this subsection 1.2) and over which the beneficiary's withdrawal power has not previously lapsed either pursuant to the provisions of subsection 1.1, above, or this subsection 1.2. The beneficiary's power of withdrawal under this subsection 1.2 shall lapse at the end of the calendar year (or on the date of the beneficiary's death, if earlier) to the extent the same shall not constitute a release of a general power of appointment by the beneficiary pursuant to the provisions of either or both Section 2041(b)(2) and/or 2514(e) of the Internal Revenue Code, or any successor sections thereto in effect at the time of the lapse, after factoring in all other lapsed powers of withdrawal of the beneficiary during the same calendar year pursuant to the provisions of either or both Section 2041(b)(2) and/or 2514(e) of the Internal Revenue Code, or any successor sections thereto in effect at the time of the lapse, including any lapse pursuant to the provisions of subsection 1.1, above. The portion of the beneficiary's withdrawal power under this subsection 1.2 which is not exercised by the beneficiary during the calendar year and which has not lapsed during the calendar year pursuant to the foregoing provisions of this subsection 1.2 shall continue to be withdrawable by the beneficiary (including any legal representative acting on behalf of the beneficiary if the beneficiary is under a legal incapacity) pursuant to the provisions of this subsection 1.2.

1.3 Satisfactions of any right of withdrawal of the beneficiary pursuant to the provisions of this subsection 1.1 and 1.2, above, must be made in cash, although the trustee may liquidate any asset of the trust (including but not limited to by withdrawing retirement assets [as defined in ARTICLE, below] and other assets which are payable to the trust over time and not yet paid to the trust) in order to generate said cash; PROVIDED, HOWEVER, that the trustee may not utilize current trust accounting income to satisfy the beneficiary's right of withdrawal under subsection 1.2, above. The trustee other than a trustee having any beneficial interest in the trust (other than solely as a contingent taker under ARTICLE, below) may, in the sole and absolute discretion of said trustee, suspend the beneficiary's withdrawal power under subsection 1.1 and/or 1.2, above, in whole or in part, by instrument in writing executed by said trustee before January 1 of the calendar year in which such withdrawal power would otherwise exist. Reasons for such suspension may include, but shall not be limited to, overall tax savings for the trust and its beneficiaries (including remainder beneficiaries), creditor protection for the beneficiary, and unwise or immature use of withdrawn funds by the beneficiary. In the event the beneficiary shall have the beneficiary's aforesaid power of withdrawal suspended, in whole or in part, the trustee other than a trustee having any beneficial interest in the trust (other than solely as a contingent taker under ARTICLE, below) may also, in the sole and absolute discretion of said trustee, restore the beneficiary's withdrawal power under subsection 1.1 and/or 1.2, above, in whole or in part, at any time, by instrument in writing executed by said trustee. The trustee shall be exonerated from any liability for any decision or non-decision under this subsection.

1.4 The trustee may, in the trustee's sole discretion, distribute, use or apply so much of the income and principal of the trust estate (which is not withdrawable by the beneficiary or by the beneficiary's legal representative pursuant to the provisions of subsection 1.1 or 1.2, above) as the trustee may deem necessary to provide for the maintenance, support, health care and education of the beneficiary, in the beneficiary's accustomed manner of living. In addition, the trustee may, in the trustee's sole discretion, distribute, use, or apply the income and principal of the trust estate (which is not withdrawable by the beneficiary or by the beneficiary's legal representative pursuant to the provisions of subsection 1.1 or 1.2, above) as the trustee may deem necessary for the maintenance, support, health care, and education of any descendant of the beneficiary; PROVIDED, HOWEVER, that (i) the needs of the beneficiary as specified above shall be the primary concern of the trustee, and (ii) neither the income nor principal of the trust may be used to limit, relieve or otherwise discharge, in whole or in part, the legal obligation of any individual to support and maintain any other individual. In determining the amounts to be distributed, used, or applied for the beneficiary's descendants, the trustee shall not be required to treat each of such persons equally but shall be governed more by the particular needs and interests of each of them. The trustee other than the beneficiary and other than a trustee designated by the beneficiary who is "related or subordinate" to the beneficiary within the meaning of current Section 672(c) of the Internal Revenue Code, or any successor section thereto (substituting "the beneficiary" for "the grantor" in said Section), may, in such trustee's sole and absolute discretion, utilize the income and principal of the trust estate (which is not withdrawable by the beneficiary or by the beneficiary's legal representative pursuant to the provisions of subsection 1.1 or 1.2, above) for the purpose of purpose of paying all or any portion of the beneficiary's income taxes, directly, or indirectly by reimbursing the beneficiary for any income taxes paid by the beneficiary, including but not limited to income tax liability accruing to the beneficiary as a result of the beneficiary's power of withdrawal under subsection 1.1 or 1.2, above; PROVIDED, HOWEVER, that the trustee shall not possess the discretionary power described in this sentence if, as a consequence of possessing said power, the beneficiary is deemed to possess the same power for federal or state estate tax, gift tax, generation-skipping transfer tax, inheritance tax, or other transfer tax purposes.

1.5 The trustee shall be entitled to rely on the advice of legal counsel with respect to any matter under this Section 1; PROVIDED, HOWEVER, that if said legal counsel's opinion is subsequently determined to be invalid as applied to this subsection, either as a result of a subsequently passed federal or state law, or a subsequently promulgated regulation or published ruling, or as a result of judicial decision, the matter shall be determined based on such subsequent development and not in accordance with said legal counsel's opinion.

Exhibit 2. Section 2 . Additional Testamentary Power of Appointment

2.1 In addition, except as otherwise provided herein in ARTICLE hereof [POTENTIAL SPECIAL PROVISIONS IF RETIREMENT ASSETS ARE PAYABLE TO THE TRUST - SEE THE DISCUSSION IN PART 2 OF THIS ARTICLE], if the beneficiary is not survived by a surviving spouse (as that term is defined for purposes of Section 2056 of the Internal Revenue Code, or any successor section thereto, or for purposes of the law of the state or other jurisdiction in which the beneficiary was domiciled at the time of his or her death, if said state or other jurisdiction has an estate or inheritance tax in effect at the time of the beneficiary's death), then to the extent it will not result in (i) the beneficiary's estate being liable for any federal or state estate or inheritance taxes (assuming no alternate valuation date or similar elections, qualified disclaimers, or deductible administration expenses), (ii) the beneficiary's estate being liable to reimburse any government for any assistance or other benefits provided the beneficiary during the beneficiary's lifetime, (iii) the beneficiary's estate or the trust being automatically subject to income tax on any gain attributable to any portion of the remaining trust assets, or (iv) a reduction in the federal income tax basis of any asset over its historical federal income tax basis, the beneficiary shall have the power to appoint those remaining trust assets, if any, beginning with the asset or assets having the greatest amount of built-in appreciation (calculated by subtracting the trust's income tax basis from the fair market value on the date of death of the beneficiary), as a percentage of the fair market value of such asset or assets on the date of death of the beneficiary, to the creditors of the beneficiary's estate (or to or among the beneficiary's estate and any one or more individuals and/or entities, including a trust or trusts, if the power to distribute such assets to the creditors of the beneficiary's estate is not sufficient to cause a federal income tax basis adjustment under Section 1014 of the Internal Revenue Code, or any successor section thereto, at the beneficiary's death), utilizing the same appointment procedure described in subsection, above; PROVIDED, HOWEVER, that if this trust has been or will be divided into two separate trusts for federal generation-skipping transfer tax purposes, the beneficiary's foregoing additional power of appointment shall apply (i) first to the trust having an inclusion ratio, as defined in Section 2642(a) of the Internal Revenue Code, or any successor section thereto, of other than zero, but only to the extent such trust is not otherwise already includible in the beneficiary's estate for federal estate tax purposes, pursuant to the other provisions of this trust instrument, and (ii) next to the trust having an inclusion ratio, as defined in Section 2642(a) of the Internal Revenue Code, or any successor section thereto, of zero; PROVIDED FURTHER, HOWEVER, that if the beneficiary is the beneficiary of more than one trust which includes a provision similar to this sentence, under no circumstance shall the beneficiary's estate be liable for any federal or state estate or inheritance tax as a consequence of the beneficiary's foregoing additional power of appointment, and if necessary to carry out this intent, the extent of the beneficiary's foregoing additional power of appointment shall be reduced in proportion to the value of all other trust assets subject to a similar additional power of appointment, or by a greater amount, if further necessary.

2.2 If the beneficiary is survived by a surviving spouse (as that term is defined for purposes of Section 2056 of the Internal Revenue Code, or any successor section thereto, or for purposes of the law of the state or other jurisdiction in which the beneficiary was domiciled at the time of his or her death, if said state or other jurisdiction has an estate or inheritance tax in effect at the time of the beneficiary's death), the beneficiary shall only possess the beneficiary's foregoing additional power of appointment to the same or lesser extent that the trustee (other than the beneficiary and other than a trustee who is "related or subordinate" to the beneficiary within the meaning of current Section 672(c) of the Internal Revenue Code (substituting "the beneficiary" for "the grantor" in said Section)) shall direct by instrument in writing filed with the trust during the beneficiary's lifetime and not revoked by said trustee prior to the beneficiary's death; PROVIDED, HOWEVER, that the trustee shall not possess the foregoing power to direct if the beneficiary appointed the trustee who or which possesses the foregoing power to direct, and if as a consequence the beneficiary is deemed to possess the foregoing power to direct for federal or state estate tax or inheritance tax purposes. In exercising said trustee's broad discretionary power in determining whether and to what extent the beneficiary shall possess the beneficiary's foregoing power of appointment if the beneficiary is survived by a surviving spouse, said trustee shall be primarily concerned with minimizing overall income and transfer taxes to the beneficiary's estate, to the beneficiary's surviving spouse's estate, and to recipients of the trust assets after the beneficiary's death, and with minimizing the liability of the beneficiary's estate to reimburse any government for any assistance or other benefits provided the beneficiary during the beneficiary's lifetime. The trustee shall be entitled to rely on the advice of legal counsel with respect to any matter under this subsection 2.2; PROVIDED, HOWEVER, that if said legal counsel's opinion is subsequently determined to be invalid as applied to this subsection, either as a result of a subsequently passed federal or state law, or a subsequently promulgated regulation or published ruling, or as a result of judicial decision, the matter shall be determined based on such subsequent development and not in accordance with said legal counsel's opinion. If no action is taken by an independent trustee pursuant to the immediately above subsection 2.2, it may still be possible for the beneficiary to create an optimum level of income tax basis step-up at the beneficiary's death by intentionally triggering the so-called Delaware Tax Trap.

1 See Regs. 1.678(a)-1, 1.671-3(c), 1.677(a)-1(g), Ex. 2.

2 See Reg. 1.643(b)-1].

3 The American College of Trust & Estate Counsel, or ACTEC, has an excellent web link on this topic.

4 See **Regs. 1.678(a)-1** , **1.671-3(c)** , **1.677(a)-1(g), Ex. 2** .

5 The married couple numbers are twice these figures.

6 Again, the married couple numbers are twice these figures.

7 432 F.2d 1278 (9th Cir. 1970).

8 Note that the "deemed release" amount will therefore vary, depending on whether following the 9th Circuit's decision in *Fish* or not.