Official Publication of the State Bar of California
Trusts and Estates Section

California Trusts and Estates Quarterly

Volume 17, Issue 1 • Spring 2011

Inside this Issue

TO BYPASS OR NOT BYPASS, THAT IS THE QUESTION: USING A FORMULA GENERAL POWER OF APPOINTMENT CLAUSE TO ADDRESS NEW ESTATE PLANNING UNCERTAINTIES

By Clay R. Stevens, Esq. and Burton A. Mitchell, Esq.***

I. NEW LEGISLATION – NEW CHOICES

In 2001, Congress passed the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).[1] That law gradually phased out the estate tax over a ten year period by increasing the applicable exclusion amount and decreasing the marginal rate, until elimination of the estate tax in 2010. The EGTRRA changes were set to expire on December 31, 2010 and the estate tax was set to return to the more onerous pre-2001 estate tax rules at that time.[2] But on December 17, 2010, Washington surprisingly came together and enacted the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act (TRA10),[3] which not only extended the more favorable estate tax provisions but added some generous new provisions.[4] Unfortunately, these new laws were only enacted for two years and thus estate planners are still faced with the uncertainty of planning with the possibility of a reversion in 2013 to pre-2001 estate tax rules. More than just the continued uncertainty, however, the new rules make estate planning for most clients much more difficult and force estate planners to address entirely new issues with all their clients.

While the TRA10 estate tax provisions did re-introduce an estate tax for all deaths after December 31, 2010, the applicable exclusion amount was raised to $5,000,000 per person and the estate tax rate was lowered to a flat 35% on amounts in excess $5,000,000.[5] As a result, a married couple through basic planning can shield the first $10,000,000 of their estate from estate taxes. The opportunity to shield a full $10,000,000 from estate tax was expanded, since the new law added a "portability" feature[6] by which the surviving spouse may be able to use the applicable exclusion amount of the first spouse to die even if the deceased spouse does not create a "Bypass Trust"[7] at death.

To help offset some of the revenue lost by complete repeal of the estate tax in 2010, EGTRRA had eliminated the unlimited step-up in income tax basis to fair market value of assets held at death.[8] As a result, the heirs of a 2010 decedent with highly appreciated assets may receive a reduced benefit from EGTRRA due to future income tax due on the bequeathed assets. But TRA10 did not include the EGTRRA carryover basis rules; instead it allowed the prior step-up in income tax basis rules to be fully restored.[9] Therefore, it is possible for many taxpayers both to avoid estate tax and to receive a full step-up in income tax basis if their plans are properly structured. But structuring an estate plan to maximize the tax benefits upon death no longer is as simple as creating a Bypass Trust at the first death.

In the past, it was relatively standard practice for married clients with more than $1,000,000 to create a Bypass Trust at the first death to utilize the applicable exclusion amount of the first spouse to pass away. At the second death, the assets of the Bypass Trust would not receive a step-up in income tax basis but would be shielded from estate tax. The amount shielded from estate tax included any appreciation on the Bypass Trust assets between the deaths of the first spouse and second spouse. However, for an estate expected to be under $5,000,000, many taxpayers under today's law would be better off from a tax perspective not creating a Bypass Trust, so that all of the assets of the estate might receive a step-up in income tax basis at the second death. By using the portability election, it might be possible for a married couple to shield up to $10,000,000 at the second death without estate tax and still receive a full basis step-up. Therefore, the easy answer might then be not to use Bypass Trusts for estates expected to be less than $10,000,000. For several reasons, the answer is not so clear.

II. PLANNING WITH UNCERTAINTY

A. Issue 1: Unknown Future of Federal Estate Tax

In drafting an estate plan, an estate planner today must make some assumption about what the federal estate tax rules will be when the taxpayer passes away at some unknown point in the future.[10] The current increased credit, as well as the portability election, are set to expire at the end of 2012.[11] If a couple with a $10,000,000 estate chooses not to create a Bypass Trust and then the law reverts to 2000 rules before the couple can amend and restate their plan,[12] the additional tax created by failing to create the Bypass Trust would be over $2,750,000. If the same couple chooses to create a Bypass Trust and TRA10 becomes permanent, appreciation in the Bypass Trust assets would create potential capital gains tax with no corresponding estate tax benefit. If the portability election is made permanent, the Bypass Trust is made even less relevant for estate tax reduction purposes.

Even if an estate planner assumes the tax law is not going to revert back to 2000 rules, one must make some assumption about whether Congress will act to fix the applicable exclusion amount at $5,000,000, $3,500,000, $2,000,000 or some other amount.[13] If the estate tax reverts to 2000 rules, the use of Bypass Trusts will again be necessary for estates as small as $1,000,000. If the credit reverts to 2009 rules without portability, a Bypass Trust might be needed for estates of $3,500,000 or more. If the portability rules are added to the 2009 rules, a Bypass Trust may only be needed for estates over $7,000,000.

Even if Washington passes legislation next year permanently fixing the applicable exclusion amount, there is no guarantee that further increases or decreases will not be imposed by a future legislature.

An added unknown factor is the estate tax rate versus the capital gains tax rate, since the use of a Bypass Trust is often a trade-off between estate tax and future capital gains tax. While the estate tax rate today is more than double the capital gains tax rate, capital gains tax rates are set to increase as well at the end of the 2012.[14]

With this continuing uncertainty about the law, it is difficult today to advise a taxpayer whether a Bypass Trust will be needed for estate tax purposes in the future when the taxpayer passes away.

B. Issue 2: Unknown Size of Taxpayer's Estate

In determining whether the estate of a couple is "large" enough to warrant the use of a Bypass Trust, most estate planners consider the fair market value of the couple's current estate. While that size of the estate is relevant if the couple is much older and has a limited life expectancy, for most clients the size of the estate is only relevant upon the death of the first spouse ("Decedent") and then upon the death of the surviving spouse ("Survivor").

For example, assume Kevin and Doris Duncan have a current estate of $5,000,000 so their estate planner decides against using a Bypass Trust. Doris dies five years later when the estate has grown to $10,000,000 and Kevin dies five years after that when the estate has grown to $15,000,000. As a result, even if TRA10 is made permanent, failure to include a Bypass Trust might result in as much as $1,750,000 in unnecessary estate tax being imposed.

Alternatively, assume Rick and Sarah Thompson have an estate of $15,000,000 today so their estate planner decides to create a Bypass Trust. Rick passes away in five years when the estate has been spent down to $8,000,000, and at Sarah's death her share of the estate is only $3,000,000 while the Bypass Trust has grown to $7,000,000. As a result, under the TRA10 rules, the Bypass Trust did not save any estate tax, but the beneficiaries could incur as much as $750,000 in capital gains tax.

To make a more informed decision about whether an estate is sufficiently large to warrant the use of a Bypass Trust, estate planners must become financial planners and ask questions other than just the value of the couple's current net worth.

- How much is a couple currently spending relative to their net worth? Do they intend to increase (or decrease) their spending in the future? The answer to these questions may be the most determinative of whether the estate is likely to swell or recede in the future, as the answer to these spending questions may be relatively easy to quantify by the couple.

- What is the couple's current income from work and how long do they intend to continue working? This is the opposite of the spending question and at minimum allows the estate planner to determine whether the couple is likely to add or subtract assets to the estate.

- What is the expected rate of return on the couple's investments and do they intend to change the asset allocation as they get older? If the couple is risk adverse and invests primarily in fixed income assets, the estate may only grow due to earnings. On the contrary, if the couple is more diversified across different asset classes and the expected rate of return is higher, the estate may still increase without any future earnings. Unlike the questions about spending and earnings, however, the answer to this question is much more speculative since it relies on market forces outside the control of the couple.

- How is the couple's health and how long do they think each spouse will live? Similar to the return estimate question, absent some known health issues, this may be the most speculative answer.

- How will the assets of the Bypass Trust (if one is created) be invested and does the Survivor anticipate needing to spend down the Bypass Trust assets? If the Bypass Trust assets are not expected to increase in value and are unlikely to have built-in capital gain at the Survivor's death, then the loss of the step-up in income tax basis is less relevant. Also, if the Survivor does not intend to spend down the Bypass Trust assets, having the growth on those assets pass without estate tax becomes more relevant.

Even couples that currently work with financial planners may be unable to answer the ultimate question of the likely size of the couple's estate at death. Also, given changes in the couple's financial affairs, answering these questions accurately requires the couple to meet regularly with the estate planner.[15] But understanding some of these questions should allow the estate planner to provide a much more accurate estimate than simply relying on the couple's current net worth.[16]

C. Issue 3: Unknown Effects of Portability

Aside from the uncertainty about whether the new portability rules will remain in the law, the use of the portability option has its own uncertainties. First, the surviving spouse may only use the unused exclusion of the *last* deceased spouse of the Survivor.[17] So planners must add to their list of questions whether the surviving spouse will re-marry and, if so, whether the new spouse will die first and will use some or all of his or her own exclusion. Second, portability does not apply to the deceased spouse's unused generation-skipping transfer (GST) tax exemption,[18] so the client (and planner) must anticipate whether the surviving spouse will want to use or increase GST transfers in the Survivor's estate plan. Last, since the deceased spouse's unused exclusion amount is limited to the "basic exclusion amount" at the time of the surviving

spouse's death,[19] uncertainty about the future of the basic estate tax exclusion carries over to the use of portability as well.

III. NON-TAX REASONS FOR BYPASS TRUST

Even if the estate planner has enough financial information to determine that a Bypass Trust is not needed for estate tax reasons, there are still many non-tax reasons to use a Bypass Trust.

A. Protection of Remainder Beneficiaries

For many couples, and especially those with children from a prior marriage, protecting the interests of the Decedent's intended beneficiaries is a primary reason to use a Bypass Trust. If no Bypass Trust is created and all the assets pass to the Survivor or a revocable survivor's trust (a "Survivor's Trust") at the Decedent's death, nothing prevents the Survivor from changing the successor beneficiaries to include a new spouse or future children.

One possible way for the Decedent to retain control of the Decedent's share of the estate while still achieving a further basis step-up at the Survivor's death would be to transfer the Decedent's share to a qualified terminable interest property trust (a "QTIP Trust") at death. The assets of the QTIP Trust would be included in the Survivor's estate for tax purposes and therefore would receive a full step-up in income tax basis, but the Decedent could designate the eventual beneficiaries of the Decedent's share of the estate. However, creating a QTIP Trust and a Survivor's Trust would complicate the estate plan and require special drafting since most traditional estate plans maximize the amount passing to the Bypass Trust first and then only transfer any excess of the Decedent's share to a QTIP Trust. In this case, the funding formula would need to be adjusted. Additionally, the QTIP Trust rules would require the QTIP Trust to distribute the trust income to the surviving spouse annually.

B. Asset Protection

Even if a couple is comfortable granting the Survivor complete control over the funds at death, a Bypass Trust may still be beneficial to provide creditor protection from the Survivor's creditors. Discretionary distributions may be made to the Survivor for the Survivor's health, education, support, and maintenance, but the Survivor's future creditors should not be able to access the principal of the trust since the grantor of the trust was the Decedent. For many clients in high risk professions, this alone is reason enough to create a Bypass Trust. While creditor protection may also be available through the use of a QTIP Trust, the QTIP Trust rules require all income to be distributed annually to the surviving spouse, thereby thwarting some of the creditor protection benefits of an irrevocable discretionary trust for the surviving spouse.

C. Asset Management

In some cases the Decedent may want to use an irrevocable trust for a surviving spouse to protect the Survivor from spendthrift habits, lack of financial sophistication in managing the trust assets, or vulnerability to abuse or undue influence. Again a QTIP Trust could be used to provide these protections while still qualifying for a stepped-up basis at the Survivor's death, but only with the strict requirements of a QTIP Trust and the complication and drafting that entails.

IV. POSSIBLE SOLUTIONS TO DILEMMA

While the increase in the applicable exclusion amount may appear to have made tax planning for couples less complicated, the reality is that it often makes tax planning more complex and will require more customization in the future. Even if the estate planner considers all appropriate factors in determining whether to utilize a Bypass Trust for estate tax purposes, factors outside the couple's control may alter the given assumptions.[20] Three possible solutions may exist to help minimize the problem.

A. Use of Disclaimer Trust

Since the death of the first spouse may occur many years after an estate plan is created, one of the biggest uncertainties in determining whether a Bypass Trust is necessary is the projected size of the estate upon the death of the Decedent. This problem can be minimized through the use of a "Disclaimer Trust" in place of a traditional Bypass Trust. With the Disclaimer Trust, the entire estate passes to the Survivor's Trust at the Decedent's death. If the Survivor makes a valid disclaimer of some or all of the Decedent's assets,[21] the disclaimed assets pass instead to a Disclaimer Trust that serves a similar function as the Bypass Trust.[22] As a result, if the Survivor determines within 9 months after the death of the Decedent that the overall estate is likely to be subject to estate tax at the Survivor's death—possibly because the estate has increased in size or the estate tax credit has been fixed at a lower number—then the Survivor can disclaim some or all of the Decedent's assets to the Disclaimer Trust. This provides the Survivor additional flexibility to postpone the determination of whether a Bypass/Disclaimer Trust is necessary until more information is available.

While the use of a Disclaimer Trust may aid an estate planner in determining whether a Bypass Trust is necessary, there are several problems with the use of a Disclaimer Trust. First, the size of the estate at the death of the first spouse may not be indicative of the size of the estate at the second death, and thus the estate planner must still address some of the same financial planning uncertainties when drafting the plan. Second, the use of a Disclaimer Trust requires an intentional act by the Survivor immediately following the death of his or her spouse and therefore requires the Survivor to know about the need to act and to take affirmative steps to effect the disclaimer. Because the Survivor may not accept any benefits from the disclaimed assets in the meantime,[23] the opportunity to make a disclaimer may be lost inadvertently or may restrict the Survivor's access to trust assets while a disclaimer is being evaluated. Third, the Survivor cannot have any discretion over the disclaimed assets,[24] so use of a Disclaimer Trust forecloses giving a limited power of appointment to the Survivor, and thus eliminates some possible desired flexibility in the estate plan.

Lastly, since the Survivor can choose not to exercise the disclaimer—even if making a disclaimer ultimately will reduce the estate tax due at the Survivor's death—the Survivor effectively controls 100% of the couple's assets. For many couples who use a Bypass Trust to help ensure that the Decedent's share passes to his or her beneficiaries at the Survivor's death, the use of a Disclaimer Trust provides the opportunity for the Survivor to thwart those wishes.

B. Use of Opt-In General Power of Appointment

If a trust grants a beneficiary a testamentary general power of appointment over the corpus of the trust, the corpus is included in the estate of the beneficiary at death.[25] A power of appointment is classified as a "general" power if the beneficiary retains the right to appoint the property at death to himself, his estate, his creditors, or the creditors of his estate ("Prohibited Appointees").[26] In a traditional Bypass Trust, the Survivor might be given some limited power to appoint the property at death but would not be given the right to appoint the property to Prohibited Appointees.[27] On the contrary, if it is desirable for the assets of a trust to be included in a beneficiary's estate,[28] a beneficiary may intentionally be given the right to appoint the property to a Prohibited Appointee in order to cause the power to be deemed a general power. However, if the trust settlor does not want to grant the beneficiary the unlimited right to appoint the property at death, the power can be limited to only the creditors of the beneficiary's estate.[29] Alternatively, to exercise control over the beneficiary, the trust could require the beneficiary to obtain consent to exercise a general power of appointment from a person who does not have a substantial interest in the trust, since this consent requirement will not convert the power to a non-general power.[30]

When an estate planner is attempting to determine whether a Bypass Trust is necessary, it would be helpful to have the flexibility to convert a non-general power of appointment into a general power, or vice versa, at some point after the couple executes the estate plan and prior to the death of the Survivor. If the assets of the Bypass Trust, when combined with the Survivor's other assets, would create an estate tax at the Survivor's death, it would be helpful to extinguish a power of appointment in the Bypass Trust or at least limit the ability to appoint to Prohibited Appointees.

One way to achieve this flexibility is to provide an independent person or committee the future right to grant to or remove from the Survivor a general power of appointment over the Bypass Trust.[31] Thus a general power of appointment could be granted well after the death of the Decedent, providing the couple a mechanism to later determine whether the Bypass Trust is necessary or whether it would be preferable to step up the income tax basis of the Bypass

Trust assets. As discussed above, if the couple did not want to grant the Survivor the unlimited right to change the beneficiaries of the Bypass Trust, such added general power of appointment could be limited to the creditors of the Survivor's estate or be subject to approval by some independent person.

While this planning seems to permit the couple to achieve both the benefits of estate tax exclusion (if needed) and a full step-up in income tax basis (if preferable to estate tax exclusion), there are some limitations to this type of clause. First, the addition or removal of this general power requires affirmative action by some third party before the Survivor's death and therefore needs to be monitored regularly. To the extent the Survivor or the Survivor's advisors do not regularly review this provision and determine whether to exercise this power, the benefit of the provision will be lost. Regular monitoring of this provision may be cost prohibitive for smaller estates— exactly the estates for which the exercise of such a provision may be especially useful.[32] Even if the provision is being monitored regularly, a premature death by the Survivor before the power can be granted or withdrawn would thwart the effective use of the provision. Lastly, if the power is granted in a limited or last minute fashion, the Service might challenge the right as illusory.[33] For example, if the power were granted to the Survivor by a third party on the Survivor's death bed, the IRS might conclude that the Survivor never had the opportunity to exercise the power.

Although this power has some limitations, in most cases there are few negatives to giving a third party the right to add a general power as a possible backstop in a traditional estate plan, since it at least provides the possibility to decide later on the necessity of the Bypass Trust. If the couple is concerned about a Survivor actually exercising a general power to divert the Bypass Trust assets from the Decedent's beneficiaries, the exercise of the general power could require the consent of an independent party who (the Decedent hopes) would protect the interests of the Decedent's beneficiaries. However, in potentially contentious situations, it might be better to accept the loss of the step-up in income tax basis on the Bypass Trust assets rather than risk an unintentional disinheritance of the Decedent's beneficiaries.

C. Use of Formula General Power of Appointment

A third alternative, the use of a formula general power of appointment, builds off the same reasoning as the opt-in general power of appointment by creating a general power of appointment in the Bypass Trust when the Bypass Trust is not needed for estate tax purposes and a step-up in income tax basis is preferred. With a formula general power of appointment, the Survivor would automatically be given a testamentary general power of appointment over the Bypass Trust, but additional language would expressly limit the Survivor's right to appoint the property to a Prohibited Appointee to the extent the Bypass Trust assets when added to the Survivor's other assets would create an estate tax on the death of the Survivor. An example of such a provision would be:

Power of Appointment

(a) The Survivor shall have the power to direct part or all of the balance of the Bypass Trust, including principal and any accrued or undistributed income, to the creditors of the Survivor's estate; provided that this power of appointment may only be exercised in favor of the creditors of the Survivor's estate with respect to any portion of the Family Trust that can pass free of federal estate tax, after taking into consideration all factors relevant to this federal estate tax objective, including, but not limited to:

(1) All deductions claimed and allowed in determining the federal estate tax liability of the Survivor.

(2) The net value of all other property included in the Survivor's estate, whether or not such property passes under this Trust Agreement or passes at the time of the Survivor's death or has passed before the Survivor's death to or in trust for any person or entity, so that it is included in the Survivor's gross estate for federal estate tax purposes and does not qualify for the federal estate tax charitable deduction.

(3) All credits and exclusions allowed for federal estae tax purposes, including but not limited to any credit allowable under IRC Section 2010(c), but not including any credit allowable under IRC Section 2011, unless and to the extent that death taxes would be payable to any state regardless of the credit allowable under IRC Section 2011.

(b) The power of appointment provided in this Paragraph shall be exercised on such terms and conditions, either outright or in trust, as the Survivor shall appoint solely by a written instrument referring to this power and evidencing an intention to exercise it, which instrument shall be dated, signed by the Survivor and delivered to the Trustee during the Survivor's lifetime.

(c) If the Survivor executes more than one such instrument the provisions of which are inconsistent, the instrument bearing the latest date shall control.

(d) The power of appointment provided in this Paragraph shall be effective only upon the Survivor's death.

Unlike the opt-in power of appointment, this provision is automatic at death and does not require any future action by the Survivor or any third party. Since the Survivor has the right to exercise the testamentary power of appointment at any time prior to death and the efficacy of the exercise would simply be tested at death, the provision is more analogous to other formula-type clauses

permitted under tax law. Specifically, formula clauses have been permitted for years in funding marital bequests and generation-skipping transfers.[34]

This type of allocation is also analogous to formulas used for charitable gifts at death. A testamentary charitable bequest of a sum is only deductible to the extent "ascertainable" upon the date of the testator's death.[35] A formula amount is ascertainable for those purposes, even though the exact amount cannot be calculated until the testator's death. Similarly, with this suggested formula the amount subject to the power of appointment can be ascertained with certainty immediately upon the death of the Survivor.

The Service has challenged the use of formula clauses in some cases, but those typically arise in defined-value clauses where the Service argues that the use of the formula clause is against public policy.[36] However, in these challenges the Service argues that the provision is against public policy since the provision discourages the collection of tax by subverting the judicial process[37] and not that the provision is designed to maximize the tax benefits afforded under the IRC. To the extent this type of formula provision was against public policy, marital deduction and generation-skipping formula clauses likewise should be against public policy. Therefore, while this specific formula clause has not been explicitly approved by any ruling by the Service, it is based on other approved formula clauses that have been widely used for many years.

While this provision appears to solve the problem of having to choose between using a Bypass Trust to reduce the estate tax and maximizing the step-up in income tax basis at death, there are situations when it might be inappropriate. As discussed with the opt-in general power, in a contentious marital situation in which the Survivor may thwart the dispositive wishes of the Decedent, this type of automatic provision might not be advisable. In that case, either foregoing the full step-up in income tax basis or requiring the consent of a third party to exercise the general power of appointment may be more appropriate. Also, any change to the power of appointment rules in the future might impact the benefits of this provision. Therefore, it may be advisable to include both the formula general power as well as an opt-in general power to provide additional flexibility. Alternatively, for much larger estates where it is clear the estate tax protection afforded by a Bypass Trust will be needed, it might be advisable not to use a formula general power at all, to protect against future changes to the power of appointment rules.

V. CONCLUSION

Estate planners today are faced with a whole new set of additional considerations due to changes introduced to the estate tax rules in the past few years. Aside from the increased credit and changing tax rates, the likelihood of future changes further complicates the analysis. As a consequence, it is often difficult adequately to determine whether to include a Bypass Trust in an estate plan for a couple who are uncertain to need the estate tax protection. In those cases, use of a formula general power of appointment might permit the couple to maximize their tax benefits by ensuring the lowest estate tax possible and the maximum use of the step-up in income tax basis at death.

** Aspiriant, Los Angeles, California*

*** Jeffer Mangels Butler & Mitchell LLP, Los Angeles, California*

1. Pub.L. No. 107-16 (June 7, 2001) 115 Stat. 38.
2. EGTRRA, section 901. Upon expiration of the EGTRRA changes, the unified credit equivalent would have reverted to $1,000,000 per person for both gift and estate transfers and the top estate tax rate would have increased to 55%.
3. Pub.L. No 111-312 (Dec. 17, 2010) 124 Stat. 3296.
4. See Zaritsky, *Observations on Estate Planning Provisions of the 2010 Tax Act* (Mar. 2011) 38 Est. Plan. 48 (listing the changes introduced by the new act).
5. Additionally, the new law reunified the gift and estate tax applicable exclusion amount so that a taxpayer can give as much as $5,000,000 without incurring a gift tax. TRA10, section 302. While this presents substantial estate planning opportunities, especially if it appears the applicable exclusion amount is going to revert to $1,000,000 in 2013, those options are beyond the scope of this article.
6. TRA10, section 303.
7. References in this article to a "Bypass Trust" are to an irrevocable trust created upon the death of the first spouse to die, which does not qualify for the federal estate tax marital deduction.
8. EGTRRA, sections 541, 542. See Blattmachr and Detzel, *Estate Planning Changes in the 2001 Tax Act—More Than You Can Count* (Aug. 2001) 95 J. Taxation 74, 80.
9. TRA10, section 301.
10. This article limits the analysis to federal estate tax rules although states with a separate estate or inheritance tax have additional issues to consider in determining the effect of the new estate tax rules on their overall taxation.
11. TRA10, section 101(a)(1).
12. The couple may be unable to amend and restate if one or both of the spouses become incapacitated.
13. The timing of any legislation may be dependent on the election cycle since politics plays a major role in tax policy, especially estate tax policy. Many estate planners assume that no permanent changes will be made until after the Presidential election in 2012 – less than two months before TRA10 expires – similar to the last minute changes to the estate tax law in 2010.
14. EGTRRA, section 901(a)(1), as amended by TRA10, section 101(a)(1).
15. This may not be desirable for cost-savings reasons or may not be possible given the couple's incapacitation.
16. This problem actually has been present ever since IRC section 1014(a) made the income tax basis step-up unlimited. However, the problem has only been made worse with the increase in the applicable exclusion amount, since it is no longer just trading future capital gains tax for estate tax, but potentially trading future capital gains tax for nothing.
17. IRC, section 2010(c)(4)(B). See Hills, *Subsequent Remarriage Complicates Exclusion Amount Portability* (May 2011) 38 Est. Plan. 3.
18. EGTRRA sections 303(b)(1) and 303(b)(2), dealing with portability, apply only to the estate and gift taxes. See Blattmachr, Gans, Zaritsky and Zeydel, *Estate Planning After the 2010 Tax Relief Act: Big Changes, But Still No Certainty* (Feb. 2011) 114 J. Taxation 68, 80.
19. IRC, section 2010(c)(4)(A).

20. For example, a couple might have an unintended windfall due to the sale of business, an extraordinary investment return or an unexpected inheritance, or might suffer a decrease due to a loss of employment or an extraordinary investment loss. Additionally, a couple may pass away unexpectedly or live longer than expected lives and need to spend down more of the estate.

21. Under IRC section 2518(b), a disclaimer is only "qualified" if made in writing within 9 months of the date of the death of the Decedent.

22. A Disclaimer Trust may be identical to a Bypass Trust, providing the Survivor with access to the assets for health, education, support, or maintenance but keeping the assets out of the Survivor's estate for estate tax purposes. While one who disclaims typically is not permitted to receive any benefit from the disclaimed assets, a special rule permits such access for a surviving spouse. IRC, section 2518(b)(4)(A). The only potential difference between a Disclaimer Trust and a Bypass Trust is that a Survivor may not retain any power to appoint the property of the Disclaimer Trust at death. See IRC section 2518(b)(4) and text accompanying note 24 below.

23. IRC, section 2518(b)(3).

24. IRC, section 2518(b)(4).

25. IRC, section 2041.

26. IRC, section 2041(b).

27. As an example, a Survivor may be given the testamentary power to appoint the property among the Decedent's issue at death and the Bypass Trust assets would not be included in the Survivor's estate, since the power would not be a general power, whether or not the Survivor exercises the power. See Treas. Reg. section 20.2041-1(c).

28. For example, it often is desirable in a non-GST exempt trust for the assets of the trust to be included in the beneficiary's estate at death instead of being subject to generation skipping transfer tax. See Gassman and Denicolo, *The Role of Credit Shelter Trusts Under the New Estate Tax Law* (June 2011) 38 Est. Plan. 10, 12.

29. This assumes that the beneficiary is less likely to appoint the property to the creditors of his or her estate. However, if a beneficiary took extraordinary steps such as intentionally creating creditors of the estate, the beneficiary could effectively retain broader control over the trust assets.

30. IRC, section 2041(b)(1)(C)(ii).

31. See Gassman, *supra* note 28, at p. 12.

32. This is especially true if the Survivor does not fully understand the complexities of making the election or the estate planner who drafted the provision is no longer representing the Survivor.

33. See *Gassman, supra* note 28, at p. 12.

34. See Zeydel and Benford, *A Walk Through the Authorities on Formula Clauses*, (Dec. 2010) 37 Est. Plan. 3, 3. See also Rev. Proc. 64-19, 1964-1 Cum. Bull. 682 (providing the authority for marital formulas); Treas. Reg. section 26.2632-1(b)(4)(i) (providing the authority for generation skipping formulas).

35. Treas. Reg. section 1.663(a)-1(b)(1).

36. See Zeydel, *supra* note 34, at pp. 3-4; *Comm'r v. Procter* (4th Cir. 1944) 142 F.2d 824.

37. See Zeydel, *supra* note 34, at p. 4.