CARTER LEDYARD

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Change in Trust and Will Provisions on Powers of Withdrawal

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Trust and Will Provisions dated January 1, 2014, were distributed as part of Practical Drafting, the discontinued quarterly estate planning publication of Bank of America, N.A. Forms relating to a power of withdrawal are:

Will Provisions [H-1f], p. 54 and [H-1j] p. 56

Trust Provisions [C-6f], p. 20, [C-6j], p. 21 and [D-8], p. 70

These provisions should be modified to make clear that the power is over a fractional share of property rather than over a specific dollar amount. This is accomplished by using the term "fractional distribution of principal." The satisfaction of a fractional share rather than a specific dollar amount should avoid any contention that a distribution of property in kind which has appreciated results in the realization of gain. Additional changes are made to simplify the form and providing the trustee with control over the principal distributed. The form below is a revision of [H-1j] of the Will Provisions. See IRC Secs. 2041(b)(2) and 2514(e).

If the holder of the power of withdrawal fails to exercise the power in a year, he or she becomes the owner of the trust for income tax purposes as to the unexercised amount pursuant to IRC Sec. 678.

[H-1j] In each calendar year commencing with the year of my death my spouse shall have the right, if living on the last day of the year, by an instrument delivered to my trustee before the close of the year, to withdraw a 5 percent fractional share of principal. Distribution shall be made promptly after the close of a calendar year. The distribution right shall not be cumulative and shall be exercisable only by my spouse and not by any guardian or other person on my spouse's behalf. The determination by my trustee of the property distributed and its value shall be conclusive upon all affected persons.

Case Study (Excluding Unified Credit)

Estate has a value of $20 million and is divided into two shares, a marital QTIP trust share of one-half and a credit shelter trust share of one-half with all taxes paid from the credit shelter share. The credit shelter trust gives the trustee a discretionary power to pay income or principal to the surviving spouse and to descendants of the decedent. The spouse is also given a five percent withdrawal power exercisable annually as of the last day of each calendar year from the credit shelter trust. The spouse neglects to exercise her power of withdrawal in each calendar year, with the result she is subject to income tax on each five percent portion, and her share of the taxable income of the credit shelter trust gradually increases. The result is similar to current law; in effect a tax-free gift is made by reducing the size of the QTIP trust through payments of income tax on the IRC Sec. 678 amount from that trust.

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