

## POWERS OF APPOINTMENT AND THE DRAFTING OF MISSOURI WILLS

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The subject of powers of appointment is often approached by attorneys with some trepidation—as something both mysterious and complex. This is probably the result, at least in part, of the fact that the thinking of the bar about powers of appointment has been colored, and perhaps confused, by federal estate and gift tax law and, to a lesser extent, by state inheritance tax statutes. Estate, gift and inheritance tax statutes have been greatly concerned, in recent years, with powers of appointment, and have brought into the law their own special definitions of powers and special rules regarding them which differ in many instances from the property law rules.

Unquestionably, powers of appointment have become increasingly important, especially in will drafting, because of tax legislation. The Federal Revenue Act of 1948<sup>1</sup> brought the marital deduction into the estate tax law, and, as all attorneys know, one of the standard methods of qualifying property for the marital deduction is the creation of a testamentary “power-of-appointment trust” meeting the requirements of section 2056(b)(5)<sup>2</sup> of the Internal Revenue Code of 1954.<sup>3</sup> Since 1951, powers of appointment have assumed an even more prominent place in will drafting and estate planning because of the amendments to the Internal Revenue Code of 1939 made by the Powers of Appointment Act of 1951.<sup>4</sup> These amendments have been carried over, virtually without change, into the estate and gift tax provisions of the Internal Revenue Code of 1954.<sup>5</sup> By making fewer powers subject to

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1. 62 STAT. 117 (1948), 26 U.S.C. § 812 (1952).

2. This section, with some liberalizing changes, is the equivalent of the INT. REV. CODE of 1939, § 812 (e) (1) (F). See SEN. REP. No. 1622, 83d Cong., 2d Sess. 1635 (1954). One of the liberalizing changes made by the INT. REV. CODE of 1954 is to permit a “specific portion” of a trust to qualify for the marital deduction. Under the INT. REV. CODE of 1939, § 812(e)(1)(F), the surviving spouse had to have a power of appointment over the “entire corpus.”

3. Pub. L. No. 591, 83d Cong., 2d Sess. (Aug. 16, 1954).

4. 65 STAT. 91 (1951), 26 U.S.C. § 811 (1952).

5. SEN. REP. No. 1622, 83d Cong., 2d Sess. 1635 (1954). The new Code does contain some new provisions, however, with respect to powers of appointment. See, e.g., INT. REV. CODE of 1954, § 674(b)(3), providing that a power to appoint by will only, other than a power to appoint accumulated income, will be excepted from the general rule of § 674(a), which provides that the grantor of a living trust will be taxed on the income from a trust, the enjoyment of the corpus and income of which is subject to a power of disposition exercisable by the grantor; § 674(b)(6), excepting from the general rule of § 674(a) a power to distribute to or accumulate income for an income beneficiary where the beneficiary has a broad special power of appointment over accumulated income; and § 2503(b), providing that a gift to a minor will not be considered a gift of a future interest and therefore will qualify for the \$3,000 annual exclusion from

estate and gift taxes, the 1951 amendments permit greater use of powers of appointment in wills, with resultant greater flexibility in the disposition of estates. Thus, for example, it is possible for property to be left in trust for the life of a person and to give the life beneficiary the power to determine how the property shall be distributed upon his death on the basis of circumstances then existing, almost as if the life beneficiary were the absolute owner of the property but without a second estate tax on it at his death.

Although often overshadowed in recent years by the tax rules regarding powers of appointment, some of the common law rules regarding powers contribute particularly to their usefulness in will drafting. Thus, at common law, with the exception of the case where the donor and the donee of the power are the same person,<sup>6</sup> creditors of the donee or of his estate cannot reach property over which the donee had a special power of appointment,<sup>7</sup> whether exercised or not. This is also true of property over which he had an unexercised general power,<sup>8</sup> although property subject to a general power which is exercised in favor of one who is not a purchaser for value or in favor of one of several creditors can be subjected to the claims of creditors if other property of the donee is insufficient.<sup>9</sup> The Federal Bankruptcy Act, section 110(a), provides that the trustee in bankruptcy of the donee of a power of appointment shall be vested, by operation of law, with the title of the bankrupt to "powers which he might have exercised for his own benefit, but not those which he might have exercised solely for some other person . . .,"<sup>10</sup> but the courts have held that a general power to appoint by will only is not within the terms of the statute.<sup>11</sup>

Another common law rule increasing the usefulness of powers in will drafting is the rule that the surviving spouse of the donee of the power is not entitled to dower or other similar marital rights in the property subject to the power whether the power is general or special and whether it is exercised or not exercised.<sup>12</sup>

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gift tax, provided, among other conditions specified in § 2503(c), that in the event that the donee dies before attaining majority any unexpended portion of the property and income will be payable to his estate "or as he may appoint under a general power of appointment as defined in section 2514(c)."

6. RESTATEMENT, PROPERTY § 328 (1948). Unless otherwise noted, whenever the Restatement is cited herein, no Missouri case has been found on the particular point and the Restatement rule is believed to represent the majority rule in the United States.

7. RESTATEMENT, PROPERTY § 326 (1940).

8. See *Krause v. Jeannette Investment Co.*, 333 Mo. 509, 517, 62 S.W.2d 890, 893 (1933); see also RESTATEMENT, PROPERTY § 327 (1940).

9. RESTATEMENT, PROPERTY § 329 (1940); see also RESTATEMENT, PROPERTY § 330 (1940).

10. 30 STAT. 544 (1898), as amended, 11 U.S.C.A. § 110(a) (1953).

11. See, e.g., *Montague v. Silsbee*, 218 Mass. 107, 105 N.E. 611 (1914); *In re Peck Estates*, 320 Mich. 692, 32 N.W.2d 14 (1948).

12. *Krause v. Jeannette Investment Co.*, 333 Mo. 509, 62 S.W.2d 890 (1933); RESTATEMENT, PROPERTY § 332, comment a (1940). *But cf.* *Link v. Edmondson*, 19 Mo. 487 (1854) *semble*.

Accordingly, by the use of a power of appointment, a testator can often achieve flexibility in the ultimate disposition of his estate based upon circumstances existing long after his death and at the same time avoid having the appointive property subject to dower and creditors' rights. Moreover, if the power is not a general one within the definition of the federal estate tax provisions of the Internal Revenue Code of 1954, he can also avoid a second estate tax upon the appointive property at the death of the possessor of the power. In many instances there is no other device by which these things can be accomplished, at least so effectively.

### I. DEFINITIONS AND CLASSIFICATION OF POWERS MOST INVOLVED IN WILL DRAFTING

Before getting into specific will drafting problems involving powers of appointment, it is necessary to review briefly the definitions and classifications of powers with which attorneys are most concerned in drafting wills.

#### *A. Definition of Power of Appointment*

The Restatement of Property defines a power of appointment as a power created or reserved by a person (the donor) having property subject to his disposition enabling the donee of the power to designate, within such limits as the donor may prescribe, the transferees of the property or the shares in which it shall be received.<sup>13</sup>

The persons to whom interests in the property are appointed by the donee are called the "appointees," and the persons who will receive property not effectively appointed are the "takers in default of appointment."<sup>14</sup>

The term "power of appointment" does not include a power of sale, a power of attorney, a power reserved to the grantor of a trust to revoke the trust, or a trustee's discretion to determine how much of the income or corpus of the trust shall be used for a particular beneficiary or for particular members of a group of beneficiaries, usually in accordance with some standard.<sup>15</sup> Furthermore, at common law, the term "power of appointment" does not include a power to cause a gift of income to be augmented out of principal.<sup>16</sup> However, as will be discussed later in this article, many powers to augment a gift of income out of principal are treated as powers of appointment for federal estate and gift tax purposes.

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13. RESTATEMENT, PROPERTY § 318 (1940).

14. *Id.* § 319.

15. *Id.* § 318, esp. comment *l.*

16. *Id.* § 318, and comment *j.*

### *B. Classifications Primarily Involved in Will Drafting*

Powers of appointment are classified by the common law in many ways, but only two classifications are primarily involved in the drafting of wills, that of the manner in which a power can be exercised and that of the scope of the power granted. Consequently, a number of types of powers, such as "powers in gross," "powers collateral" and "powers appendant," will not be discussed in this article, and others will be discussed only incidentally in connection with specific will drafting problems.

#### *1. Manner in Which Power Is Exercisable*

The first classification with which attorneys are primarily concerned in will drafting has to do with the manner in which the power can be exercised. Powers of appointment can be exercisable by deed during lifetime, by will, or by either will or deed, depending upon what the instrument creating the power provides.<sup>17</sup> The Restatement of Property terms powers that are exercisable by deed, or by either deed or will, powers "presently exercisable."<sup>18</sup> Powers to appoint by will only are often called "testamentary powers."<sup>19</sup>

The method by which a power can be exercised should not be confused with the method by which it is created. Although powers of appointment can, of course, be created by almost any instrument used to transfer property interests—by will or by deed or by inter vivos indenture or declaration of trust—the manner in which a power is created is relatively unimportant in determining the common law incidents of the power. The manner in which it may be exercised is important, since the rules of law applicable to the power may differ, depending upon whether it is exercisable by deed or by will.

#### *2. General Power v. Special Power*

The other important classification of powers in the law of property so far as will drafting is concerned is that which classifies a power as a "general power" or a "special power." A power is general if it can be exercised wholly in favor of the donee, in the case of a power exercisable before death, or can be exercised wholly in favor of the donee's estate, in the case of a testamentary power, regardless, in each case, of whether the power can be exercised in favor of other persons.<sup>20</sup> A power is special if it can be exercised only in favor of persons other than the donee who constitute a group not unreasonably large.<sup>21</sup> An

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17. *Id.* § 321.

18. *Id.* § 321, comment *d.*

19. *Id.* § 321.

20. *Id.* § 320.

21. *Ibid.*

example of a special power would be a power given to an individual to appoint by his will certain designated property to his children. Special powers are sometimes called "limited powers."<sup>22</sup> Of course, either a special power or a general power may be exercisable by deed or will or both, depending upon the terms of the instrument creating the power.

It should be borne in mind that the foregoing are property law definitions of powers of appointment. The tax law definitions, the most important of which are discussed below, differ in a number of respects, particularly in the scope of the definition of a general power for federal estate and gift tax purposes.

It also should be mentioned at this point that powers of appointment have been the subject of statutory treatment for various non-tax purposes in a number of states, but not in Missouri. Except for the section involving Missouri inheritance tax with respect to appointive property,<sup>23</sup> there is no statutory law in Missouri dealing with powers of appointment.

## II. CREATING BY WILL A POWER OF APPOINTMENT

The will draftsman and his client must first determine, of course, whether it is desirable to confer a power of appointment by the will being drafted. Then, if the decision is made to create such a power, the attorney becomes concerned with the various problems involved in drafting it.

### A. *Determining When to Create a General Power*

General powers of appointment are created in a variety of situations.

#### 1. *Marital Deduction Trust*

The bar is now quite familiar with the "power-of-appointment trust" used to qualify property for the marital deduction for federal estate tax purposes.<sup>24</sup> One of the requirements of such a trust is that the surviving spouse must have a power of appointment over the entire corpus, or a specific portion thereof. Under the provisions of the Internal Revenue Code of 1954, the power must be exercisable

in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others . . . with no power in any other person to appoint any part of the interest, or such specific portion, to any person other than the surviving spouse.<sup>25</sup>

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22. RESTATEMENT, PROPERTY § 320, comment c (1940).

23. Mo. REV. STAT. § 145.030 (1949).

24. As a result of the changes in the federal estate tax law made by the new Code, a legal life estate with power of appointment of the specified type will now qualify for the marital deduction, as well as a life estate in trust with such a power of appointment. INT. REV. CODE of 1954, § 2056(b) (5).

25. *Ibid.*

The surviving spouse's power, "whether exercisable by will or during life," must be "exercisable by such spouse alone and in all events."<sup>26</sup> Meeting the definition of a general power in the powers of appointment section<sup>27</sup> of the estate tax law is not enough to qualify the trust for the marital deduction; all the requirements of section 2056 (b) (5) of the Internal Revenue Code must be met.

Detailed discussion of the marital deduction in general, and even of the requirements of a "power-of-appointment trust" for purposes of the marital deduction, is beyond the scope of this article, but since the most frequently encountered power today is the power of appointment used in connection with such a trust, a brief discussion of such powers of appointment appears not to be out of place.

A clause which has been used in a number of wills for the purpose of giving a surviving spouse a qualifying testamentary power over the corpus of a marital-deduction trust is the following:

Upon the death of my wife, \_\_\_\_\_, the trustees shall distribute all the money and other property then constituting this trust estate unto such persons and in such proportions or amounts as my wife shall have directed by her last will and testament specifically referring to the power of appointment hereby conferred upon her, it being my intention hereby to confer upon my wife an unqualified power, exercisable by her alone and in all events, to appoint by her last will and testament the entire corpus of this trust estate, free of the trust, unto such persons, including the estate of my wife, and in such proportions or amounts as she may direct.

In the event that my wife shall fail to exercise the aforesaid power of appointment or shall fail to appoint all the money and other property constituting the trust estate at her death, then in either such case, upon the death of my wife, all the money and other property of this trust estate with respect to which my wife shall have failed to exercise such power of appointment shall . . . [disposition to takers in default of exercise of the power should follow].

The Treasury Regulations under the 1939 Code provide that formal limitations on the power given to a surviving spouse will not disqualify the trust, that is, such limitations as the requirement that the power must be exercised by a will executed by the surviving spouse after the decedent's death or that the exercise must be by a specific reference to the power.<sup>28</sup>

It is just as important in the case of the power of appointment for purposes of the marital deduction as in the case of any other power of appointment to provide takers in default of exercise, a subject discussed at greater length elsewhere in this article. Many marital-

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26. *Ibid.*

27. *Id.* § 2041(b) (1).

28. U.S. Treas. Reg. 105, § 81.47(a) (1949).

deduction trusts provide that, in default of exercise of the power, the corpus of the trust shall be disposed of in the same manner as the corpus of another trust created by the will. Wills often provide that the unappointed property be poured over into a trust of the remainder of the testator's residuary estate (a so-called conventional trust); the will directs the addition of the unappointed property to the conventional trust at the surviving spouse's death, or incorporates by reference in the marital-deduction trust the provisions of the conventional trust.

## 2. *Situations Not Involving the Marital Deduction*

In cases other than those involving a marital-deduction trust, a general power of appointment may be desirable for the purpose of permitting the donee to obtain the property or the income therefrom by exercise of the power, if he needs the property or income, but to let others have it in the meantime.

Of course, conferring a general power of appointment will create estate tax problems for the donee, unless the amount of the appointive property and the donee's own estate together are less than the \$60,000 specific exemption from federal estate tax.<sup>29</sup> Under the amendments made to the estate tax law by the Powers of Appointment Act of 1951, which have been carried over, virtually without change, into the Internal Revenue Code of 1954,<sup>30</sup> and which replaced retroactively the difficult, artificial and restrictive rules brought into the law by section 403 of the Revenue Act of 1942,<sup>31</sup> if a general power, as defined by the Powers of Appointment Act amendments, is created<sup>32</sup> after October 21, 1942,<sup>33</sup> the appointive property is included in the donee's gross estate for federal estate tax purposes whether or not the power is exercised.<sup>34</sup>

A general power of appointment, for estate tax purposes, is defined,

29. INT. REV. CODE of 1954, § 2052.

30. See note 5 *supra*.

31. 56 STAT. 798 (1942), 26 U.S.C. § 811(f) (1952). This legislation had in turn replaced the rule under Revenue Act of 1926, § 302(f), 44 STAT. 24 (1926), as amended by the Revenue Act of 1932, § 802(b), 47 STAT. 279 (1932), which subjected to estate tax only "property passing under a general power of appointment exercised by the decedent [donee]."

32. INT. REV. CODE of 1954, § 2041(b) (3), contains a special provision to the effect that a power of appointment created by a will executed on or before October 21, 1942, shall not be considered a power created after that date if the testator died before July 1, 1949, without having republished his will, by codicil or otherwise, after October 21, 1942.

33. The present law treats differently powers created on or before October 21, 1942. If a general power was created on or before that date, the appointive property is includible in the donee's gross estate for estate tax only if the power is exercised and only if it is general, that is, only if it is exercisable in favor of the donee, his estate, his creditors, or the creditors of his estate, and is exercisable by the donee alone and not in conjunction with any other person. INT. REV. CODE of 1954, § 2041(a) (1) and § 2041(b) (1) (B).

34 *Id.* § 2041(a) (2).

with a few exceptions,<sup>35</sup> as one that is exercisable in favor of the donee, his estate, his creditors, or the creditors of his estate.<sup>36</sup> Property subject to a general power created after October 21, 1942, will also be includible in the donee's gross estate for federal estate tax purposes if he has exercised or released the power by an inter vivos disposition of such nature that, if it were a transfer of the donee's own property, the property would be includible in the donee's estate as constituting a transfer within the meaning of sections 2035 to 2038, inclusive, of the Internal Revenue Code of 1954, such as a transfer in contemplation of death or because of the reservation of powers or interests by the transferor, *e.g.*, the right to income or the power to alter, amend or revoke the transfer.

The estate tax law expressly excludes from the definition of a general power of appointment a power "to consume, invade, or appropriate property for the benefit of the decedent [donee] which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent. . . ."<sup>37</sup> The question arises, of course, as to what is an "ascertainable standard." Presumably, a power of encroachment to maintain and support the life beneficiary of a trust "in the manner and at the standard of living to which he was accustomed during the life" of the testator, donor of the power, would be limited by "an ascertainable standard"; hence, the life beneficiary would not be considered the donee of a general power. On the other hand, by analogy to the charitable deduction cases, a power of encroachment for a beneficiary's "comfort" or "pleasure" or "happiness" would clearly not be governed by an ascertainable standard.<sup>38</sup>

Giving the donee a general power which permits him to obtain the property or the income therefrom by exercise of the power if he should need it, but to let others have it in the meantime, may also create gift tax problems for the donee of the power. This is because the gift tax provisions of the Internal Revenue Code substantially parallel the estate tax provisions, including those defining a general power, the

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35. Among the exceptions are those of INT. REV. CODE OF 1954, § 2041(b) (1) (C), excluding in whole or in part from the definition of a general power certain joint powers. These exceptions provide in substance that if the power is not exercisable except in conjunction with the donor of the power, the power is not deemed a general power; that if the power is not exercisable except in conjunction with a person having a substantial interest in the appointive property which is adverse to the exercise of the power in favor of the donee, his estate, his creditors, or the creditors of his estate, the power is not deemed to be a general power; and that if a joint power is not excluded from the definition of a general power under the foregoing rules, it will be deemed to be a general power only as to a fractional part of the appointive property if some or all of the property may be appointed in favor of other co-holders of the power.

36. INT. REV. CODE OF 1954, § 2041(b) (1).

37. *Id.* § 2041(b) (1) (A).

38. *Cf.* *Henslee v. Union Planters Bank*, 335 U.S. 595 (1949); *Merchants National Bank v. Commissioner*, 320 U.S. 256 (1943).

provisions concerning lapse of powers (discussed below), those concerning the time of creation of powers, and the special provisions as to joint powers.<sup>39</sup> If a general power was created after October 21, 1942, the exercise or release thereof is a taxable gift.<sup>40</sup>

Moreover, a general power in the circumstances mentioned may even cause the income from the appointive property to be taxed to the donee for income tax purposes, although the writer has found no decided cases which have gone quite that far as yet. In *Mallinckrodt v. Numan*,<sup>41</sup> the beneficiary of an irrevocable living trust, created by his father, was held taxable upon the income of the trust under section 22(a) of the 1939 Code even though the income had not been paid to him. The ground given for the decision was that the trust provided that the income was to be paid to the beneficiary upon his request. The language of the court's decision seems broad enough to cause the income of a testamentary trust to be taxed to a beneficiary given the same power to request the income:

It seems to us, as it did to the majority of the Tax Court, that it is the possession of power over the disposition of trust income which is of significance in determining whether, under section 22(a), the income is taxable to the possessor of such power, and that logically it makes no difference whether the possessor is a grantor who retained the power or a beneficiary who acquired it from another.<sup>42</sup>

The so-called Mallinckrodt Regulations under the 1939 Code are not, by their terms, limited to inter vivos trusts, although they do use the term "grantor," a term normally used with respect to living trusts, in providing that where

a person other than the grantor of property transferred in trust has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, the income therefrom shall be included in computing the net income of such person.<sup>43</sup>

The section of the new Code<sup>44</sup> which codifies the Mallinckrodt Regulations, with some exceptions, likewise is not expressly limited by its terms to living trusts, although it similarly uses the term "grantor."

On the brighter side of the picture for the taxpayer, it does not seem to make any difference, so far as the Missouri inheritance tax is concerned, whether a power is general or special, for the inheritance tax statute on its face purports to apply to the devolution of property upon the exercise or non-exercise of any power, general or special.<sup>45</sup>

Despite the federal tax disadvantages of a general power, a general

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39. INT. REV. CODE of 1954, § 2514.

40. *Id.* § 2514(b).

41. 146 F.2d 1 (8th Cir. 1945), *cert. denied*, 324 U.S. 871 (1945).

42. *Id.* at 5.

43. U.S. Treas. Reg. 118, § 39.22(a)-22 (1953).

44. INT. REV. CODE of 1954, § 678.

45. MO. REV. STAT. § 145.030 (1949).

power may sometimes be desirable, because of peculiar circumstances, even in situations not involving the marital deduction. Of course the tax disadvantages in such cases should be carefully pointed out to the testator-client, so that he can make the final decision with them in mind.

### 3. Powers Inadvertently Created

Because of the breadth of the definition of a general power of appointment in the federal estate and gift tax law, the attorney-draftsman must use great care in drafting conventional trusts where rights of withdrawal or encroachment are to be given, even though he does not intend to place in the trust what is normally thought of as a power of appointment.

#### a. Rights of Withdrawal

If a life beneficiary of a trust is given an unlimited right of withdrawal—that is, a right to demand the payment of corpus to himself without conditions, limitations or restrictions—he undoubtedly has a general power of appointment for federal estate<sup>46</sup> and gift<sup>47</sup> tax purposes. Even if the beneficiary is given a right of withdrawal limited to a specified amount annually, the life beneficiary may have estate and gift tax problems. One of the most difficult features of the 1942 estate and gift tax legislation, as to powers, concerned the power often given to an income beneficiary to withdraw a stated amount of capital each year from the trust corpus with provision for the power to lapse at the end of the year, if not exercised. If the income beneficiary permitted the power to lapse, would he thereby make a gift at the end of the year to the remaindermen of the amount which he could have taken less the value of his life interest therein? If so, it would be a gift of a future interest not qualifying for the \$3000 annual exclusion from gift tax.<sup>48</sup> If the beneficiary-donee did make such a gift, would not the amount thereof be also includible in his gross estate for federal estate tax at his death, under section 811 (c) of the 1939 Code, as a transfer with income reserved by the transferor or a transfer intended to take effect in possession or enjoyment at or after his death?

The present law, embodying the amendments made by the Powers of Appointment Act of 1951, eliminates some of these problems. Now, if an annual right of withdrawal was created on or before October 21, 1942, failure to exercise the right does not have estate or gift tax consequence.<sup>49</sup> If an annual right of withdrawal was created after October 21, 1942, lapse of the power at the end of the year, because not exercised, is not deemed a release of the power and therefore is

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46. U.S. Treas. Reg. 105, § 81.24(a) (1954).

47. U.S. Treas. Reg. 108, § 86.2(b) (1954).

48. INT. REV. CODE of 1939, § 1003(b)(3).

49. INT. REV. CODE of 1954, § 2041(a)(1) (estate tax) and § 2514(a) (gift tax).

not taxable for estate or gift tax purposes unless the appointive property, that is, the property which could have been withdrawn but was not, exceeds in value, at the time of lapse, the greater of \$5000 or 5% of the aggregate value of the corpus at the time of lapse, and then only to the extent that the amount which could have been withdrawn but was not exceeds this limit.<sup>50</sup>

In other words, if the power is to draw \$5000 or less per year from corpus, the holder of the power need not be concerned about the estate and gift tax consequences of letting the power lapse by non-exercise, and this is true also if the power is to draw annually no more than 5% of the corpus of the trust. If the unexercised power permits withdrawal of more than the greater of \$5000 or 5% of the corpus of the trust, estate and gift tax liability is incurred, but only with respect to the amount by which the property which could have been withdrawn exceeds the \$5000 or 5% limit.<sup>51</sup>

Estate and gift tax problems in connection with rights of withdrawal given to a life beneficiary of a trust can, therefore, be avoided by limiting the amount which can be withdrawn each year to \$5000 or 5% of the value of the corpus. This could be accomplished by a clause something like the following:

I direct the trustees to pay over to my wife, \_\_\_\_\_, free of trust, out of the corpus of the trust estate, such sums of money or other assets as my wife may at any time and from time to time during her lifetime request the trustees in writing to pay over to her, but my wife shall have no right to withdraw from the corpus of the trust estate, in any one calendar year, money or other property which shall exceed in value or amount, in the aggregate, the greater of Five Thousand Dollars (\$5000.00) or five per cent (5%) of the aggregate value, at the end of such calendar year, of the assets then constituting the corpus of the trust estate, and the right of withdrawal from the corpus of the trust estate herein conferred upon my wife shall not be cumulative from year to year.

#### *b. Powers of Encroachment*

Estate and gift tax problems can also be created for a trust beneficiary if a power is conferred to encroach upon the corpus for emergencies or for the life beneficiary's support in the event that income from the trust is insufficient, or upon some other condition, and that power is given either: (a) to the beneficiary alone; or (b) to the trustees and the beneficiary happens to be one of the co-trustees, if the other co-trustees do not have an interest adverse to that of the beneficiary. Of course, if the encroachment power given to the beneficiary or to the trustees is limited by "an ascertainable standard relating to the health, education, support, or maintenance" of the beneficiary,

50. INT. REV. CODE OF 1954, § 2041 (b) (2) (estate tax) and § 2514(e) (gift tax).

51. U.S. Treas. Reg. 105, § 81.24(b) (1954).

there is no problem, since, as noted above, such a power is expressly excluded from the definition of a general power for both estate<sup>52</sup> and gift<sup>53</sup> tax purposes. The problem as to what constitutes "an ascertainable standard" has been discussed briefly above.<sup>54</sup>

If the testator does not wish to use an ascertainable standard but wants greater flexibility so that encroachment upon corpus can be made for such things as the beneficiary's "comfort" or "welfare," the safest course to follow in drafting the will is to give the encroachment powers to the trustees and to provide that the beneficiary, if he is a co-trustee, shall not participate in any way in the decision of the trustees as to encroachment. This could be done by a clause something like the following:

In the event that my wife, \_\_\_\_\_, shall, at the time of any such alleged need affecting her, be acting as co-trustee hereunder, then in such case, notwithstanding anything hereinabove contained, the discretion herein conferred to encroach upon the corpus of the trust estate shall be exercised exclusively by the other co-trustees or co-trustee then acting, without participation by my wife in the consideration by the trustees of the propriety or the amount of such encroachment, the other co-trustees or co-trustee being given sole and exclusive discretion with respect thereto and full authority to make any and all payments and distributions pursuant to such encroachment.

Perhaps the most conservative course would be to follow this procedure even when the draftsman thinks that there is an ascertainable standard, until court decisions throw more light upon the subject.

One writer suggests that this course be followed also where a father is named as co-trustee of a share left in trust for his minor child and the trustees are given powers of encroachment, lest it be contended by the Internal Revenue Service that since the father had the power, as a co-trustee, to apply principal as well as income to the use of his minor child in discharge of his duty to support his child, he has, in effect, a power to appoint to himself.<sup>55</sup> Accordingly, he suggests that the authority be vested solely in the other co-trustees.<sup>56</sup>

## B. Drafting Special Powers

### 1. Determining When to Create a Special Power

What are some of the considerations in determining whether or not to create a special power of appointment?

Special powers can be used in many situations to give flexibility in the disposition of property after a life estate based upon circumstances

52. INT. REV. CODE of 1954, § 2041(b) (1) (A).

53. *Id.* § 2514(c) (1).

54. See text at II (A) (2) *supra*.

55. Trachtman, *Estate Planning* in PRACTISING LAW INSTITUTE, CURRENT PROBLEMS IN FEDERAL TAXATION SERIES 168 (1951).

56. *Ibid.*

as they exist at that time and yet avoid some of the tax problems inherent in a general power.

When a testator creates a life estate he does not know what the circumstances of his family will be at the death of the life tenant. Some relatives, because of illness or misfortune, may be in much greater need than others. One child may have polio, or may have been left a destitute widow with small children. Another may have married a wealthy husband or wife and therefore be in very high income tax brackets, so that much of any additional income would be taxed away. One grandchild may have proved to be a spendthrift, so that his share would be best placed in a spendthrift trust, whereas another grandchild may have shown himself to be a good businessman and may be in need of cash to go into business for himself. The testator, therefore, may want to give the life tenant, or some other person in whose judgment he has confidence, a special power of appointment over the remainder, so that at the end of the life tenancy the property can be appointed on the basis of circumstances as they then exist, rather than upon the basis of circumstances existing at the time of the testator's death. Whether the testator wants to create a special power of appointment for such purposes is, of course, an individual decision which he alone can make, and he alone must determine the scope of any special power which he desires to create.

## 2. *Drafting the Special Power*

In drafting a special power of appointment there are a number of things to observe, although perhaps they could all be lumped under the general heading "good draftsmanship." Some of these things are equally applicable to the drafting of general powers, while others obviously are involved only with special powers of appointment.

### a. *Definiteness as to Permissible Appointees*

One thing which should always be observed in drafting a special power is to be as definite as possible as to who are permissible appointees. If the spouse or descendants of any member of a designated class of appointees who may be deceased at the time of appointment may be included as appointees, the will should expressly so state.

### b. *"Exclusive" Power v. "Non-Exclusive" Power*

The draftsman should also be very clear and precise in drafting a special power as to whether the power is to be "exclusive" or "non-exclusive"<sup>57</sup>—that is, whether the donee, in making appointments in exercise of the power, can completely exclude a member of a designated class of permissible appointees. The doctrine of non-exclusive

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57. RESTATEMENT, PROPERTY § 360 (1940).

powers was recognized by the Supreme Court of Missouri in *Von Behrn v. Stoeppelmann*,<sup>58</sup> where, as dictum, the court said that a power to appoint " 'unto my children . . . to be divided as my wife may direct by will or otherwise . . . ' " was a non-exclusive power, so that the wife could not exclude any of the children. The court there held, however, that grandchildren of the testator, the children of a child deceased at the time of appointment, had no right to have anything appointed to them and that, accordingly, the exercise in question was valid.

The Restatement of Property adopts the rule that:

[T]he donee of a special power may, by an otherwise effective appointment, exclude one or more objects of the power from distribution of the property covered thereby, unless the donor manifests a contrary intent.<sup>59</sup>

Nevertheless, to avoid any possible doubt, where an exclusive power is intended, it would seem desirable to spell out the donor's intention.<sup>60</sup>

If, in drafting a special power of appointment exercisable in favor of children, the draftsman says "among my children," it is not clear whether the power is exclusive or non-exclusive. It would be better to say "among all of my children," if the power is to be non-exclusive, or to say "to such one or more of my children to the exclusion of others," if the power is to be exclusive.

### *c. Specification of Minimum Amount to be Appointed*

Another thing which might well be done if a special power is to be non-exclusive is to specify a minimum amount or percentage of the appointive property to be given to each member of the class of appointees, so as to avoid the problems which have arisen from the doctrine of "illusory appointments," which are held in equity to be invalid. This is a doctrine or rule of law, in some jurisdictions, to the effect that the donee of a non-exclusive special power of appointment will be held to have perpetrated a fraud upon the donor of the power if he gives a merely nominal share to one of the possible appointees under the non-exclusive power.<sup>61</sup>

The Supreme Court of Missouri said in *Fries v. Fries*,<sup>62</sup> that it disapproved of the entire doctrine of illusory appointments, but this was dictum in that case, and the writer has found no case actually holding that the doctrine is not in force in Missouri.<sup>63</sup> In the absence of any

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58. 286 Mo. 83, 86, 226 S.W. 875, 878 (1920).

59. RESTATEMENT, PROPERTY § 360 (1940).

60. *Id.* § 360, comment *d.*

61. *Id.* § 361.

62. 306 Mo. 101, 109, 267 S.W. 116, 118 (1924).

63. See *e.g.* *Von Behrn v. Stoeppelmann*, 286 Mo. 83, 93, 226 S.W. 875, 880 (1920), where the court refused to pass upon the question of whether the doctrine of illusory appointments was in force in Missouri.

Missouri decision upon the point, and particularly since the Restatement of Property adopts the illusory appointments doctrine,<sup>64</sup> it appears desirable to specify a minimum amount or percentage to be given to each member of a designated class of permissible appointees if the testator desires a special power to be non-exclusive.

*d. Specification that Appointments in Trust May Be Made*

The general rule is that the donee of a general power can make appointments in trust, as well as outright appointments, even if the terms of the instrument creating the power prohibit him from making appointments in trust;<sup>65</sup> and the donee of a special power can make appointments in trust unless prohibited from so doing by the instrument creating the power.<sup>66</sup> Nevertheless, in the absence of Missouri precedent, if the testator desires the donee to have the right to appoint in trust, it would probably be good draftsmanship to spell out this right, particularly in the case of special powers.

*e. Express Exclusion of Donee, His Estate, etc.*

As pointed out above, a general power is defined in the federal estate and gift tax law, with some exceptions, as a power which is exercisable "in favor of the decedent, his estate, his creditors, or the creditors of his estate."<sup>67</sup> To avoid possible taxation of the power as a general power, particularly if the scope of permissible appointments under the power is quite broad, it is often desirable, in drafting the special power, expressly to exclude, as possible appointees, the donee, his estate, his creditors and the creditors of his estate.

*f. Naming of Takers in Default*

Another suggestion in connection with the drafting of special powers is that takers in default of exercise of the power should always be named. A gift in default is desirable, not only because the person creating the power may have specific wishes in the matter, but also because, as a result of the doctrine of "powers in trust,"<sup>68</sup> where a special power is not exercised and there is no express gift in default, litigation can easily arise as to whether the appointive property passes to all members of the class of permissible appointees or reverts to the heirs at law or residuary devisees of the creator of the power. A power in trust is a special power which the donee is under a duty to exercise at some time and in some way.<sup>69</sup> If the court determines an

64. RESTATEMENT, PROPERTY § 361 (1940).

65. *Id.* § 356, comment b.

66. *Id.* § 358.

67. See note 36 *supra*.

68. See *Von Behrn v. Stoepplmann*, 286 Mo. 83, 226 S.W. 875 (1920) (recognizing the doctrine of powers in trust).

69. RESTATEMENT, TRUSTS § 27, comment b (1935). However, it should be noted that RESTATEMENT OF TRUSTS § 27, comment c, points out a difficulty in

unexercised power to be a power in trust, it will usually hold that all members of the class of possible appointees are entitled to the appointive property in equal shares.<sup>70</sup> It is quite apparent how easily litigation can arise when a special power is not exercised and no takers in default have been named in the instrument creating the power.

#### *g. Express Authorization of Release of Power*

In drafting a special power, or, perhaps even more important, in drafting a general power, it may be desirable to include a provision authorizing release of the power by the donee and specifying the mechanics of release. The release of a power of appointment, which should not be confused with disclaimer (discussed below),<sup>71</sup> may be likened to the giving of a quitclaim deed to property, to use a rough analogy. It means giving up something which the donee accepted and possessed. The federal estate and gift tax laws do not tax disclaimers of powers of appointment,<sup>72</sup> but the gift tax does apply to releases of general powers created after October 21, 1942,<sup>73</sup> and the estate tax is also involved in some releases of such powers.<sup>74</sup>

Under the 1942 estate and gift tax legislation as to powers, there was a provision, repeatedly extended until 1951, whereby certain powers of appointment could be released tax-free, either completely or partially, so as to cut them down to non-taxable powers.<sup>75</sup> Some tax-free releases of powers were also permitted under the amendments to the estate and gift tax law made by the Powers of Appointment Act of 1951 for a brief "grace period" after enactment of the amendments.<sup>76</sup> Today, there are no provisions for tax-free releases of powers, but it is not beyond the realm of possibility that the estate and gift tax law may be amended in the future to permit some tax-free releases of general powers. In view of this possibility, in creating a general power, and perhaps also in creating a special power, since the estate and gift tax law may be otherwise amended in the future to tax some special powers, it may be desirable to include a provision expressly authorizing release of the power by the donee and specifying the mechanics of release, even though a power of appointment is generally releasable at common law<sup>77</sup> except, in the case of special powers, where

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ascertaining takers upon non-exercise of a power which does not name takers in default even when the power is not one in trust.

70. RESTATEMENT, TRUSTS § 27, comment *b* (1935).

71. See text at III(A) (1) (a) *infra*.

72. *Ibid*.

73. INT. REV. CODE of 1954, § 2514(b).

74. *Id.* § 2041(a) (2).

75. Revenue Act of 1942, §§ 403(d) (3) and 452, 56 STAT. 944, 952 (1942), as amended by 64 STAT. 260 (1950).

76. INT. REV. CODE of 1939, §§ 811(f) (1) and 1000(c) (1).

77. RESTATEMENT, PROPERTY § 334 (1940) (general powers); RESTATEMENT, PROPERTY § 335 (1948) (special powers). The latter represents a change from the rule originally adopted in the Restatement.

the donor manifests a contrary intention.<sup>78</sup> Indeed, the Treasury Regulations under the 1939 Code provide, for both estate and gift taxes, that

it is assumed that all general powers of appointment are releasable, unless the local law on the subject is to the contrary, and it is presumed that the method employed to release the power is effective, unless it is not in accordance with the local law relating specifically to releases or, in the absence of such local law, is not in accordance with the local law relating to similar transactions.<sup>79</sup>

Despite these provisions in the regulations under the 1939 Code, because of the possibility that some interested party might contend that the power is not releasable, there would seem to be no harm, in general, in providing, in a will creating a power of appointment, that the donee of the power can release it in whole or in part and in specifying the mechanics of release. Some such clause as the following might be sufficient to accomplish this:

Any person upon whom a power of appointment is conferred by the next preceding paragraph of this testament may, at any time during his or her lifetime, release such power of appointment with respect to any or all of the property subject thereto and may, at any time and from time to time, limit or further limit the appointees in whose favor such power may be exercised, any such release or limitation to be by instrument in writing executed and acknowledged by the donee of the power in the manner required by the laws of the State of Missouri for a conveyance of real property and delivered to the then-acting trustees hereunder.

#### *h. Illustrative Clauses*

Perhaps some of the problems which should be watched for and considered in the drafting of special powers will be pointed up by illustrative will clauses creating special powers of appointment.

For example, a clause creating a special power, exercisable by will, to appoint to descendants of the donee, with provision for takers in default of appointment, could read something like this:

Upon the death of such child, the trustees shall forthwith distribute, free of this trust, all the money and other property then constituting his or her share of the trust estate unto or for the benefit of such child's descendants, or such one or more of them to the exclusion of others, and in such proportions or amounts and upon such trusts, if any, and upon such other conditions, as such child shall have appointed and directed by his or her last will and testament.

In the event that such child shall fail to exercise the aforesaid power of appointment or shall fail to appoint all the money and other property constituting his or her share at his or her death,

78. RESTATEMENT, PROPERTY § 335 (1948).

79. U.S. Treas. Reg. 105, § 81.24 (1954) (estate tax regulations); U.S. Treas. Reg. 108, § 86.2 (1954) (gift tax regulations, identical in substance with estate tax regulations).

then in either such case, all the money and other property in respect of which such child shall have failed to exercise such power of appointment shall . . . [followed by provisions specifying takers in default].

A clause creating a conditional special power to appoint to any person except the donee, his estate, and the creditors of the donee and of his estate (the purpose of these exclusions being, of course, to prevent federal estate and gift taxation of the power as a general power) could provide:

If such child shall leave no descendant him or her surviving, such child's share shall be paid over and distributed, free of this trust, to such persons, corporations or institutions (not including, however, such child's estate or creditors or the creditors of his or her estate), and in such proportions or amounts, and upon such trusts, if any, and such other conditions, as such child, by his or her last will and testament specifically referring to the power of appointment hereby conferred upon such child, shall have appointed and designated.

In the event that such child shall fail to exercise the aforesaid power of appointment . . . [provisions follow specifying takers in default].

### III. EXERCISING BY WILL A POWER OF APPOINTMENT

Let us turn from the drafting of powers of appointment to some of the problems involved in exercising them.

#### *A. Determining Whether or Not to Exercise a Testamentary Power*

Logically and practically, the first problem here is that of deciding whether or not a particular power possessed by the testator, as donee thereof, should be exercised by his will. In some cases there may be possible alternatives which, for tax or other reasons, should be carefully considered.

##### *1. From a Tax Standpoint, Can and Should a General Power Be Disclaimed, Released or Exercised During Lifetime or Exercised by Will in Favor of Qualified Charity?*

Many times it may be very important for a testator to disclaim, release or exercise a general power of which he is named donee in such manner as to avoid or minimize estate taxation of the power, if this is possible. As pointed out above,<sup>80</sup> the release of a general power created after October 21, 1942, involves gift tax liability and may involve estate tax liability. However, there are sometimes alternative courses when a testator possesses or is named donee of a general power which is unwanted or undesirable from the estate tax standpoint.

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80. See text at II(A) (2) *supra*.

### *a. Disclaimer of Power*

The Internal Revenue Code provides that disclaimer or renunciation of a general power created after October 21, 1942, will not be considered a taxable release of the power for either estate<sup>81</sup> or gift<sup>82</sup> tax purposes. Disclaimer is an act by which an individual refuses to accept an estate, interest or power which has been given to him by deed, will or other instrument.<sup>83</sup> Disclaimer has the effect of preventing the estate, interest or power from ever vesting in the person who disclaims it.<sup>84</sup>

The Internal Revenue Code provisions raise the question of whether, under Missouri law, a power of appointment can be disclaimed, at least without disclaimer of all other interest in the property subject to the power, such as a life estate given to the person who is also the donee of the power. In Missouri, a legacy under a will may be disclaimed if the disclaimer is made within a reasonable time after the testator's death,<sup>85</sup> but the writer has been unable to find any judicial precedent in Missouri (or elsewhere) on the question of whether a disclaimer may be made of a power of appointment as a matter of property law, much less on the question of whether, in order to disclaim a power of appointment, the donee of the power must also disclaim or renounce all other interests in the property subject to the power. Presumably, though, a power may be disclaimed as a matter of property law and without giving up other interest in the property. However, if a general power is to be disclaimed by the donee so as to keep it from being considered a general power for federal estate and gift tax purposes, disclaimer must be made within a reasonable time after the donee learns of its existence, *viz.*, within a few months.<sup>86</sup>

### *b. Exercise or Release of Power During Lifetime*

Because the gift tax rates are lower than the estate tax rates, the holder of a general power of appointment may be better off, tax-wise, to exercise it during his lifetime, if it is exercisable during lifetime, or to release the power during his lifetime, even if he has to pay a gift tax upon the exercise<sup>87</sup> or release, than to have it taxed as part of his estate at his death if he dies possessing it. This is true, of course, only if he can exercise or release the power during lifetime in such manner as to keep the appointive property from being

81. INT. REV. CODE of 1954, § 2041(a)(2).

82. *Id.* § 2514(b).

83. BLACK'S LAW DICTIONARY 585. (3d ed. 1933).

84. *Seifner v. Weller*, 171 S.W.2d 617, 624 (Mo. 1943).

85. *Seifner v. Weller*, 171 S.W.2d 617 (Mo. 1943); *see Sanders v. Jones*, 347 Mo. 255, 262, 147 S.W.2d 424, 427 (1941).

86. *See* U.S. Treas. Reg. 105, § 81.24 (1954) (estate tax, 1939 Code); U.S. Treas. Reg. 108, § 86.20 (1954) (gift tax, 1939 Code).

87. Exercise during lifetime in favor of a qualified charity will probably prevent any gift tax upon exercise of the power. INT. REV. CODE of 1954, § 2522.

subject to estate tax as part of his estate at the time of his death, *e.g.*, as a transfer in contemplation of death. Exercise or release of the power during lifetime would not prevent estate tax upon the appointive property in the event that the donee should die within three years of the exercise or release, unless the donee's estate could sustain the burden of proof which would be upon it to show that the exercise or release had not been in contemplation of death.<sup>88</sup>

If the holder of the power also has a life estate in the property subject to the power, he probably cannot prevent estate tax upon the appointive property by exercising or releasing the power *inter vivos* unless he can give up his life estate and is willing to do so.<sup>89</sup> A spendthrift clause might prevent him from giving up his life estate even if he wished to do so.

### *c. Exercise of Testamentary Power in Favor of Qualified Charity*

Even when the donee has not disclaimed an otherwise taxable general power or cannot or does not wish to exercise or release it *inter vivos*, there may still be another "out" in some cases, if it is important for estate tax purposes to get the appointive property out of the gross estate of the donee. If the donee does not particularly care whether the property goes to relatives, he can exercise the power by his will in favor of a qualified charitable organization, so as to give his estate a charitable deduction for the value of the appointive property.<sup>90</sup>

## *2. Considerations in Determining Whether or Not to Exercise a Power in Other Cases*

Now let us assume that the testator does not wish to or cannot get rid of a taxable power during his lifetime or exercise it by will in favor of a qualified charity, or that the power is a special one and therefore does not involve federal estate and gift tax problems for him.

There is still the question of whether to exercise the power by will or to let the appointive property go to the takers in default. In the case of most testators who possess testamentary powers, there are a number of things to be considered in determining whether or not to exercise the power.

### *a. Personal Considerations*

Among the most important factors to be considered in making this determination are considerations which are entirely personal to the testator. In the case of a childless widow who has been given a power of appointment by her husband's will, the takers in default may be her husband's collateral relatives, and she may wish the appointive

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88. *Id.* §§ 2035 and 2041(a)(2).

89. *Id.* §§ 2036(a)(1) and 2041(a)(2).

90. *Id.* § 2055(b).

property to go to her own relatives and therefore may wish to exercise the power.

Conversely, a widow in these circumstances may feel morally obligated not to exercise the power, feeling that the property should go to her husband's relatives. In another case, the takers in default of exercise of the power may be the donee's own children, and they may take, as takers in default, in just the relative proportions that the donee would direct if he were to exercise the power. Considerations of this sort are, of course, entirely personal to the testator, and he himself must make the decisions with respect to them. However, factors other than the personal ones sometimes enter into the decision as to whether or not to exercise a power of appointment, and sometimes the other factors will override the personal considerations.

*b. Is the Power a General One Created on or before  
October 21, 1942?*

The fact that the power is a general one which was created on or before October 21, 1942, may alone be sufficient reason for the testator not to exercise it. As noted above, exercise of a general power created on or before that date will cause the property subject to the power to be included in the donee's estate for federal estate tax purposes, even if exercised in favor of persons other than the donee, his estate or creditors. On the other hand, it will not be included in his estate if the power is *not* exercised.<sup>91</sup>

*c. New Capital Gain or Loss Basis for Recipients of  
Appointive Property*

Until the enactment of the Internal Revenue Code of 1954, another important consideration in determining whether or not to exercise the testamentary power involved the income tax liability of those who would receive the appointive property, that is, the gain or loss which they would realize when they later sold or exchanged the property.

Section 113(a)(5) of the Internal Revenue Code of 1939 provided, in effect, that where property passed without a full and adequate consideration under a general power of appointment exercised by will, it took, in the hands of the recipients, a new basis for determination of gain or loss upon later sale or exchange by them. The new basis was the value which the property had for estate tax purposes in the estate of the person exercising the power. Property subject to a special power, whether exercised or not, and property passing to takers in default of exercise of a general power retained its old basis; this basis generally was the estate tax value of the appointive property in the estate of the donor of the power if the power was created by will, or the value in the hands of the donor if the power was created in his

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91. See text at II(A)(2) *supra*, and note 33 *supra*.

lifetime. The provision contained in section 113(a) (5) of the 1939 Code has been retained in the Internal Revenue Code of 1954.<sup>92</sup> The new law has added a provision, however, not found in the old law, giving a "stepped-up" basis in the case of a decedent dying after December 31, 1953, for

property acquired from the decedent by reason of death, form of ownership, or other conditions (including property acquired through the exercise or non-exercise of a power of appointment), if by reason thereof the property is required to be included in determining the value of the decedent's gross estate . . .

either under the estate tax provisions of the Internal Revenue Code of 1954 or under those of the Internal Revenue Code of 1939.<sup>93</sup> The new provision contains the ambiguous qualification that it shall not apply to "property described in any other paragraph"<sup>94</sup> of the subsection, which includes the provision carried over from the 1939 Code. It appears, however, that persons receiving appointive property at the death of the donee of a general power includible in the donee's gross estate for federal estate tax purposes will now receive a "stepped-up" basis for the property, under the one paragraph or the other, whether the power is exercised or not exercised.

#### *d. Possible Increase in Fiduciaries' Commissions*

Another factor in determining whether or not to exercise the power is the possible increase in trustees' or executors' commissions resulting from the exercise. If property held in trust is appointed to another trust by exercise of a power, often an extra trustee's principal commission will result since there will be one upon distribution by the trustees of the trust in which the property was originally held and another upon distribution from the trust to which the property is appointed at the termination of that trust. Possibly, too, executors' commissions could be increased by exercise of the power, if the property must pass through the hands of the executors of the person exercising the power. The Restatement of Property takes the position, however, that normally there is no justification for the additional expense caused by having the executors of the donee of the power make distribution to the appointees, since normally the trustees who held the property prior to the exercise of the power can distribute directly to the appointees.<sup>95</sup>

So far as Missouri powers are concerned, the writer has been informed that this is the practice of the trust companies in St. Louis and Kansas City, that is, they make distribution directly to the appointees, regardless of whether the appointments are made in trust or

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92. INT. REV. CODE of 1954, § 1014(b) (4).

93. *Ibid.*, § 1014 (b) (9).

94. *Ibid.*

95. RESTATEMENT, PROPERTY § 329, comment *h* (1940).

outright. The trust companies normally do delay distribution, however, until the time for contest of the donee's will has elapsed, a precaution which seems quite justifiable. Also, unless the right of contribution for federal estate tax<sup>96</sup> has been negated by the donee's will, the writer understands that a corporate fiduciary will normally delay making distribution to the appointees until it has reached some agreement as to contribution with the executors of the donee of the power.

*e. Subjecting Appointive Property to Claims of Creditors*

In some cases there may be another consideration in determining whether or not to exercise a power. As pointed out above, the general rule is that the one situation in which the creditors of the donee can reach appointive property is where the power is general and is exercised in favor of a person who is not a purchaser for value or in favor of one of several creditors.<sup>97</sup> If there is anything in the circumstances of the testator-client which particularly indicates that he may be insolvent at his death, he may not wish to exercise a general power and thus possibly subject the property to creditors' claims, but may prefer to let it go to the takers in default.

*B. Drafting the Will Which is to Exercise a Testamentary Power*

Let us assume, now, that the testator has decided to exercise a power of appointment which he possesses. What are some of the things which should be considered in drafting the will which is to exercise that power?

*1. The Rule against Perpetuities*

One of the most important things to bear in mind is the Rule against Perpetuities. The effect of this rule on the exercise of the powers is one of the few things in the common law as to powers of appointment on which there is some Missouri precedent. The Missouri rule appears, from decision and dictum, to be that in determining the validity of an appointment under a special power or under a general power to appoint by will only, the period of the Rule against Perpetuities is counted from the time of the creation of the power, but that in determining the validity of an appointment under a general power presently exercisable—that is, exercisable during lifetime—the period of the Rule against Perpetuities is counted from the time of the exercise of the power. The general rule in the United States appears to be the same.<sup>98</sup>

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96. See note 115 *infra*.

97. See note 9 *supra*.

98. RESTATEMENT, PROPERTY §§ 391 and 392 (1944).

In *St. Louis Union Trust Company v. Bassett*,<sup>99</sup> the testatrix had a general power of appointment exercisable by will only, which had been conferred upon her by the will of her father. By her will, she exercised this power by creating a trust for several named beneficiaries, none of whom had been living at the time of the death of her father. The testatrix provided that the property was to be held in trust for the named beneficiaries until they attained the age of forty, at which time it should be distributed to them, and she further provided that if any of the named beneficiaries should die before attaining that age, leaving children surviving, the deceased beneficiary's share of the income was to be paid to his or her children until the youngest of the named beneficiaries attained the age of forty, at which time the share of the deceased beneficiary was to be paid over to his or her children, free of trust. The Supreme Court of Missouri held that this exercise by the testatrix of the power of appointment violated the Rule against Perpetuities because the trust fund, under the appointment, would not vest in the beneficiaries within the lifetime of the testatrix and twenty-one years thereafter. In its opinion, the court said:

Then, in section 953, Gray says: "There is no dispute that the exception does not extend to special powers. Now, as a practical matter, from the point of view of the Rule against Perpetuities, there is no difference between a testamentary general power and a special power."

It is sufficient here to say that the better reason and the great weight of authority supports the views which we have quoted from Gray, *Corpus Juris*, and *Ruling Case Law*, *supra*. Reaching this conclusion, we hold that the time as affects the power of appointment as to the trust fund is to be reckoned from the time of its creation by the father of testatrix in 1872, and not from the time of its execution by her in 1928.<sup>100</sup>

In *Rutherford v. Farrar*,<sup>101</sup> the St. Louis Court of Appeals also recognized the rule that the perpetuities period is computed from the time of the creation of the power except in the case of a general power exercisable during lifetime, but held valid the exercise of the power in question, under which the donee had made an appointment in trust, because of lack of proof that the appointees were not living at the time of the creation of the power.

When the testator desires to make appointments under a special power or under a general power exercisable by will only, and to have the property held in trust for the appointees, how should the will be drafted? Generally, in a situation of this sort, appointive property

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99. 337 Mo. 604, 85 S.W.2d 569 (1935).

100. *Id.* at 624, 85 S.W.2d at 580.

101. 118 S.W.2d 79 (Mo. App. 1938).

should not be included in a residuary trust with property owned by the donee of the power if all interests in that trust will not vest within lives in being at the time of the creation of the power and twenty-one years thereafter.

When appointive property is included in a residuary trust, violation of the rule will not be prevented simply by an over-all perpetuities "saving clause" of the type commonly used in wills—to the effect that no trust created by the will shall under any circumstances continue for more than twenty-one years after the death of the last survivor of those beneficiaries living at the death of the testator-donee. A saving clause relating the duration of the residuary trust to the time of the creation of the power would seem to be effective to prevent violation of the Rule against Perpetuities, but such a clause would often be quite awkward or unduly restrictive upon the duration of the trust of the donee's own property.

Instead of including appointive property in a residuary trust of the donee's own property, the writer recommends that a testator normally exercise a power, other than a general power presently exercisable, by a separate item or article of his will in such manner as to prevent violation of the Rule against Perpetuities. For example, a person with an exclusive special power to appoint by will to his descendants and those of the donor could use a clause something like the following:

I hereby exercise the power of appointment given me by the last will and testament of my father, \_\_\_\_\_, dated \_\_\_\_\_, so as to appoint all the property subject to such power at the date of my death to the trustees hereinafter named in Item \_\_\_\_\_ hereof, TO HAVE AND TO HOLD the same unto them and their successors, IN TRUST, HOWEVER, for the uses and purposes hereinafter specified and with all the powers, rights, privileges, duties and discretions hereinafter conferred upon them and their successors in trust by Item \_\_\_\_\_ hereof.

I direct the trustees to divide and set apart all the money and other property appointed to them by this item into such number of equal shares as shall be necessary to provide one such share for each child of mine living at the time of my death and one such share for the descendants then living, collectively, of each child of mine then deceased, among whom it shall be subdivided, per stirpes and not per capita, such shares and subdivisions to be disposed of as follows:

(1) Each share or subdivision set apart for a child or descendant who was not living at the death of my father shall be paid over and distributed to him or her free of trust.

(2) Each share or subdivision set apart for a child or descendant who was living at the death of my father shall be held and retained in trust by the trustees as a separate and distinct trust estate, and the trustees shall pay over and distribute all the net income therefrom, in quarterly installments, to the child or de-

scendant for whom such share or subdivision was set apart, so long as such child or descendant shall live, and upon his or her death shall pay over and distribute, free of trust, all the money and other property then constituting the share or subdivision set apart for such child or descendant (a) to the then living descendants of such child or descendant, per stirpes and not per capita, or (b) if none, to my then living descendants, per stirpes and not per capita, or (c) if none, to the then living descendants of my father, ....., per stirpes and not per capita.

Of course, even the shares of those who were not alive at the death of the donor could be held in trust for twenty-one years after the donee's death, though no longer, instead of being distributed outright as provided in the illustrative clause; in fact, most testators would probably prefer that to the outright distribution used in that clause to keep it reasonably short. Also, the shares set apart for persons who were alive at the death of the creator of the power would not have to be distributed free of trust upon their deaths but could be retained in trust for twenty-one more years, during the minority of the remaindermen.

There are undoubtedly many good alternative methods. One alternative might be to make appointments only for the benefit of children and other descendants living at the time of the creation of the power and then, in the residuary trust of the testator's own property, direct adjustments in the size of the shares of that trust so that all beneficiaries will receive substantially equal treatment, looking at the will as a whole.

Before leaving the subject of the Rule against Perpetuities, perhaps some mention should be made of the fact that there are parallel provisions in the federal estate<sup>102</sup> and gift<sup>103</sup> tax law dealing with the Rule against Perpetuities which might cause some confusion unless the reader is familiar with their background. Suffice it to say that these provisions were aimed at the State of Delaware and are generally considered to apply only to Delaware powers.<sup>104</sup>

## 2. Residuary Clauses and "Blending Clauses"

It is rather well settled in Missouri that there is no exercise of a power of appointment by a residuary clause in the usual form, such as, "All the rest, residue and remainder of my estate, both real and personal, of whatever kind and description and wherever situated, and to which I am in any manner whatsoever entitled, I give, devise and bequeath to X."<sup>105</sup> This is not the rule, however, in some other states

102. INT. REV. CODE of 1954, § 2041(a)(3).

103. *Id.* § 2514(d).

104. SEN. REP. No. 382, 82d Cong., 1st Sess. 359 (1951) (regarding the Powers of Appointment Act of 1951); Trachtman, *op. cit. supra* note 55, at 167.

105. Standley v. Allen, 349 Mo. 1115, 163 S.W.2d 1012 (1942); Weiss v. St. Louis Union Trust Company, 142 S.W.2d 1103 (Mo. App. 1940).

which have adopted statutes providing that a residuary clause exercises a power of appointment unless the testator indicates a contrary intention.<sup>106</sup> If the testator-donee owns real property in a state other than Missouri, the attorney drafting his will should, of course, check the statutes of that state.

It is the general common law rule in the United States, however, that, except where the donor expressly requires formalities in the exercise of the power which are not observed, a "blending clause" including in the residuary estate all property over which the testator possesses "any power of appointment" is sufficient to exercise all powers which the testator possesses that are exercisable by will.<sup>107</sup> This appears to be the rule in Missouri as well.<sup>108</sup>

Blending clauses are often used in wills to take care of unknown powers. The writer believes that this is an undesirable practice for several reasons. For one thing, if the residuary estate is left in trust, inclusion of appointive property may cause violation of the Rule against Perpetuities, as pointed out above.<sup>109</sup> Moreover, the exercise of a general power created on or before October 21, 1942, will cause inclusion of the appointive property in the gross estate of the holder of the power for federal estate tax purposes, whereas it will not be included if the holder of such a power dies without exercising it.<sup>110</sup> Exercise of a power by a "blending clause," therefore, could cause a large increase in estate taxes in a case where the donee might be quite willing to have the property go to the takers in default.

### *3. Observation of any Limitations upon Exercise Imposed by the Donor*

A few words seem particularly desirable with respect to special powers. In exercising a special power, the donee should be particularly careful to observe all of the limitations placed upon the power by the instrument creating it. The importance of making appointments to appointees authorized by the donor and appointments of the kind permitted by the special power is perhaps obvious from some of the things mentioned in the discussion of the drafting of special powers.<sup>111</sup> The judicial precedents indicate, also, the importance of observing even formal limitations upon the exercise of any power, general or special.<sup>112</sup>

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106. For a list of such statutes in effect on January 1, 1947, and a discussion of variations between such statutes, see RESTATEMENT, PROPERTY § 343, comment *d* (1948).

107. RESTATEMENT, PROPERTY § 341 (1940).

108. *Cf.* Collier's Will, 40 Mo. 287 (1867).

109. See text at III(B)(1) *supra*.

110. See note 33 *supra*.

111. See text at II(B)(2) *supra*.

112. *Grace v. Perry*, 197 Mo. 550, 567, 95 S.W. 875, 879 (1906) (by implication); see *Taylor v. Taylor*, 243 S.W.2d 310, 316 (Mo. 1951).

#### 4. *Treatment of Powers Which Are Not to be Exercised*

When a testator possesses a power which he does not wish to exercise, the writer suggests that the draftsman include in the will a clause expressly so stating, particularly since it is always possible that the testator could die domiciled in, or owning real property in, a state where a residuary clause exercises all powers exercisable by will unless there is a provision in the will to the contrary.<sup>113</sup> A clause to prevent a contention that a residuary clause was intended to exercise a power could be something like the following:

I do not desire or intend to exercise, by this my last will and testament, and accordingly do not exercise, (a) any general power of appointment as defined by the Internal Revenue Code and created on or prior to October 21, 1942, or (b) any testamentary power of appointment granted to or conferred upon me by the last will and testament of my ....., it being my intention that all property over which I shall possess any such power as above identified shall pass under and as provided in the instrument creating such power in the event of my failure to exercise the same.

#### 5. *Partial Exercise of Powers to Pay Death Taxes*

Section 2207 of the Internal Revenue Code of 1954<sup>114</sup> provides that, unless the decedent directs otherwise in his will, his executor shall be entitled to contribution, for estate tax, from the persons receiving property by reason of the exercise, non-exercise or release of a power of appointment included in the decedent's gross estate for estate tax purposes. The amount which the executor can recover is the proportionate part of the total estate tax payment which the property subject to the power bears to the sum of the taxable estate and the \$60,000 specific exemption.<sup>115</sup> However, there are some exceptions in the law in the case of appointive property which has qualified for the marital deduction in the decedent's estate.<sup>116</sup>

Very often the right of contribution or reimbursement provided for in section 2207 is negated in wills. Sometimes, however, a person with a general power—such as a surviving spouse for whom a marital-deduction trust was created—may have a rather small probate estate of her own but a large estate tax bill because of the power. For sentimental reasons, a surviving wife may want her own property to go to her children so that she can feel that she has left them something, rather than have it consumed entirely or to a great extent in paying estate taxes attributable to property which is subject to a power of appointment that she possesses. Even if the widow is not so senti-

113. See note 106 *supra*.

114. The equivalent provision in the INT. REV. CODE of 1939 was found in § 826(d). See SEN. REP. No. 1622, 83d Cong., 2d Sess. 1635 (1954).

115. INT. REV. CODE of 1954, § 2207.

116. *Ibid.*

mental, she may not want her executors to be faced with the problem of raising the cash necessary to pay estate taxes and then seeking reimbursement later under the federal statutory procedure or, for that matter, under applicable state law.<sup>117</sup> Or, if appointive property causes the donee's own property to be thrown into a higher bracket and taxed at higher rates, the donee of the power may want to have more of the total estate taxes paid from the appointive property than is provided for by the federal statute. In cases like these, partial exercise of a general power to pay estate taxes may accomplish the testator's desires, with the rest of the appointive property going to the takers in default.<sup>118</sup> The following is an illustration of a clause partially exercising a taxable power for the purpose of having the estate tax attributable to the power paid from the appointive property:

Anything in this testament to the contrary notwithstanding, any federal estate taxes which shall be attributable to property with respect to which I shall at the time of my death possess any testamentary power of appointment shall be borne by and paid out of such property, to the extent hereinafter provided, and I accordingly hereby exercise any such testamentary power of appointment in part by directing the payment, from the property subject thereto, of such federal estate taxes as shall be attributable to such property, determined as hereinafter provided, such payment to be made to my executors and to be used by them to pay such taxes, the exact amount of such taxes attributable to any such property, as aforesaid, to be the full amount of federal estate taxes imposed upon my estate resulting from inclusion of such property in my gross estate; and I direct that the determination of my executors as to the full amount of federal estate taxes resulting from the inclusion in my gross estate of the appointive property shall be final and conclusive upon all persons whomsoever.

Except to the extent provided in the immediately preceding paragraph, I do not desire or intend to exercise by this my last will and testament any power of appointment which I may possess at the time of my death, and I further direct that, subject to the provisions of the immediately preceding paragraph, my executors shall have no right of contribution or exoneration for any federal or state inheritance or estate taxes paid by them in respect of any proceeds of any policies of insurance upon my life payable to beneficiaries other than my estate or in respect of any other property which, by operation of law, shall be included in my estate for federal or state estate or inheritance tax purposes.

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117. Cf. *Carpenter v. Carpenter*, 267 S.W.2d 632 (Mo. 1954).

118. It seems quite clear that if a power is *created* for the purpose of providing funds for the payment of estate taxes, that power will constitute a general power of appointment for federal estate and gift tax purposes. See U.S. Treas. Reg. 105, § 81.24 (1954) (estate tax regulations, 1939 Code, providing that "a power of appointment exercisable to meet the estate tax, and any other taxes, debts, and charges which are enforceable against the estate, is included within the meaning of a power of appointment exercisable in favor of the decedent's estate or the creditors of his estate"); U.S. Treas. Reg. 108, § 86.2 (1954) (gift tax regulations, 1939 Code, containing the same provision).

This clause does not spell out the allocation of taxes between powers when the testator has two or more powers includible in his gross estate for federal estate tax purposes, and the draftsman might wish to make some express provision as to this.

The partial exercise of the power could also include state inheritance taxes, but this becomes rather complicated because of the nature of the inheritance tax and the varying exemptions given different beneficiaries, depending upon their relationship to the decedent.<sup>119</sup> It is for this reason that the illustrative clause is limited to federal estate taxes.

#### CONCLUSION

The ancient device of the common law, the power of appointment, with, or perhaps despite, its modern sophisticated gloss of tax rules, can be a very useful device in will drafting and estate planning. Properly used, it can accomplish many things otherwise unattainable. It can give flexibility in the disposition of property based upon circumstances as they exist long after the owner's death, without the appointive property being subjected to a second estate tax at the death of the donee of the power or to the claims of the creditors of the donee or dower rights of the donee's spouse. The writer submits that, in the drafting of wills, the bar can and should use powers of appointment far more than they have been used in the past.

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119. Mo. Rev. Stat., § 145.090 (1949).

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