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THE FIVE OR FIVE POWER: AN OBSCURE ESTATE PLANNING TOOL

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I. INTRODUCTION

If property is transferred in trust for the life of A with the trustee being directed to distribute the assets of the trust to A on an objective standard, such as A's health, education, and support, none of the assets of the trust will be includable in A's gross estate for federal estate tax purposes on his death.[1] A's beneficial life interest in the trust terminates on the date of his death. On the other hand, if A has the power to withdraw on his own volition the assets of the trust, his power of withdrawal will be regarded for federal estate tax purposes as a presently exercisable general power of appointment, with the result that the assets of the trust will be includable in his gross estate on his death.[2] In between these two extremes, however, lies the so-called "five or five power," one of the most useful, and perhaps one of the least understood, estate planning tools that should at the very least be considered by the draftsman of every trust agreement.[3] The five or five power is the power of the beneficiary of a trust to withdraw annually $5,000 or five percent of the assets of the trust. Most draftsmen, after determining the federal estate, gift, and income tax ramifications of this power will probably conclude that most trust agreements should give each beneficiary an unfettered right to withdraw annually a small amount or percentage of the assets of the trust subject to the power of withdrawal.[4] Both the beneficiary with this unfettered right of withdrawal and the trustee of the trust with no discretion with respect to this potential annual distribution, after taking into consideration this added flexibility, will not be as preoccupied with the exact amount of any distributions from the trust to that beneficiary under any objective standard, in which case, this lack of concern will tend to reduce any friction between the beneficiary and the trustee.

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[1] INT. REV. CODE of 1954, § 2041(b)(1)(A) (1970) [hereinafter cited as IRC 1954]; Treas. Reg. § 20.2041-1(C)(2) (1961).

[2] IRC 1954, § 2041(b)(1); Treas. Reg. § 20.2041-1(c)(1) (1961).

[3] IRC 1954, § 2041(b)(2); Treas. Reg. § 20.2041-3(d)(3) (1958); IRC 1954, § 2514(e); Treas. Reg. § 25.2514-3(c)(4) (1958).

[4] A. CASNER, ESTATE PLANNING 717 (3d ed. 1961) [hereinafter cited as A. CASNER].

This article focuses on the federal estate, gift, and income tax consequences of a five or five power, an exception to the general rules of sections 2041(b)(2) and 2514(e) that the lapse of a general power of appointment constitutes a *transfer* of the appointive property by the donee to the takers in default, that is, those persons who would be entitled to the appointive property if the donee did not exercise his power of appointment.[5] This transfer of the appointive property by the donee to the takers in default may not only constitute a gift by the donee for federal gift tax purposes, but, if the donee retains an interest in the appointive property that he has transferred to the takers in default, it may remain in his gross estate for federal estate tax purposes on his death.[6]

II. THE FEDERAL ESTATE AND GIFT TAX CONSEQUENCES OF THE RELEASE AND LAPSE OF A GENERAL POWER OF APPOINTMENT

A person may be given the power to transfer property (1) to any one or more persons in a designative group, for example, his children, on the date of his death, and (2) at a given time, for example, by will, on the date of his death.[7] If, however, the group of persons in whose favor the power of appointment may be exercised by the donee is not limited by the donor, the donee may dispose of the appointive property as he pleases and may even transfer the appointive property to himself or his estate.[8] This power of appointment is commonly referred to as a "general" power of appointment in order to distinguish it from a "special" power of appointment, namely, one which can be exercised only in favor of a limited group of persons, not including the donee of the power or his estate.[9] Furthermore, if the donor does not restrict the *time* of the exercise of the power of appointment, the donee may appoint the property by *deed* as soon as the power of appointment is created or by *will* at the donee's death.[10] Thus, if the

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[5] The income tax consequences of a five or five power are governed by IRC 1954, § 678. *See* Rev. Rul. 67-241, 1967-2 CUM. BULL. 225.

[6] For example, if property is transferred to a trust for A for life, with the remainder to such person or persons appointed by A by deed, and if A exercises this presently exercisable power of appointment by appointing the remainder interest in the trust to X, the assets of the trust will be included in A's gross estate for federal estate tax purposes on his death under IRC 1954, § 2036(a)(1). *See* Treas. Reg. § 20.2041-3(d)(1) (1958).

[7] V AMERICAN LAW OF PROPERTY § 23.1 (1952).

[8] *Id.*

[9] *Id.*

[10] *Id.*

donor neither limits the group of persons to whom an appointment can be made nor restricts the time of its exercise, the donee's dominion and control over the appointive property is tantamount to outright ownership.[11]

A power of appointment may be terminated by either the donor or the donee. For example, the donor may terminate the power by revoking it, assuming that he has retained the right of revocation.[12] The donee, on the other hand, may terminate the power (1) by exercising the power in favor of one or more persons named as appointees, (2) by releasing the power, or (3) by letting the power lapse, for example, by dying without having exercised the power.[13] Since the release or lapse of a general power of appointment may be just as effective a means of determining the devolution of appointive property as the exercise of the power, a release or lapse of a general power constitutes a "transfer" by the donee of the appointive property for federal estate and gift tax purposes.[14] For example, assume that a donee, age 35, has the power until he attains the age 50 to appoint by deed the assets of a trust to any one or more persons, including himself, his estate, his creditors, and the creditors of his estate, with a gift in default of appointment equally to A, B, and C. If the donee wants the assets of the trust to pass equally to A, B, and C, he can either (1) appoint the assets of the trust to A, B, and C in equal shares, (2) release his power of appointment over the assets of the trust, or (3) let the power of appointment lapse by simply refusing to exercise it.[15] In all three instances, the donee by either acting or refraining from acting, may transfer the appointive property equally to A, B, and C. Stated simply, the donee of a general power of appointment effectively gives the appointive property to the takers in

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[11] *Id.* at § 23.4.

[12] *Id.* at § 23.31.

[13] *Id.* at § 23-25. The lapse of a general power of appointment could be camouflaged. For example, assume A creates a trust for B for life, with the remainder to C. The trust, however, is revocable by B on December 31 of each year, and in case of revocation, the assets of the trust pass to B. If B dies before December 31 in the year the trust is created by A, none of the assets of the trust will be includable in B's gross estate on the date of B's death, because, on the date of his death, he would not have a power to revoke the trust. Furthermore, if B dies on June 30 of the following year, he, on the date of his death still would not have the power to revoke the trust. But, the trust would be includable in B's gross estate on the date of his death under section 2041, because he let a general power of appointment, that is, his power to revoke the trust, lapse on December 31.

[14] IRC 1954, § 2041(a)(2) [release] and (b)(2) [lapse]; IRC 1954, § 2514(b) [release] and (e) [lapse].

[15] V AMERICAN LAW OF PROPERTY § 23.25 (1952).

default by either releasing the power or by refusing to exercise the power in favor of himself or some person or persons other than the takers in default. The appointive property, however, like any other gift, may still be includable in the donee's gross estate under sections 2035 through 2038, provided, the donee either (1) transfers the appointive property in contemplation of death, or (2) retains a "string" on the appointive property of sufficient strength to withstand the force which possibly may be exerted in attempting to pull it back into his gross estate.[16] For example, if the donee releases a general power of appointment in contemplation of death, the appointive property would be includable in his gross estate under section 2035.

The principal difference between a release and the lapse of a general power is that a release, like the exercise of a power, takes some active conduct by the donee, for example, the execution of some instrument evidencing his intent to relinquish his power to transfer the property to some one or more persons other than the takers in default.[17] A lapse, on the other hand, simply requires the donee to refrain from exercising the power, in which event the appointive property will pass to the takers in default in accordance with the terms of the power of appointment. Thus, if a donee has a general power of appointment until he attains age 50 and he attains that age without exercising the power, the remainder interests in the takers in default will no longer be subject to divestment by him.[18] If the donee in this example is a life beneficiary of the appointive property, he will be deemed to have made a transfer with a retained life interest on the date the power lapses.[19] Even in the situation where the donee has no interest in the appointive property other than a power to alter the dispositive scheme for the devolution of the appointive property set up by the donor of the power, the donee will be deemed to have made a transfer on the date the power lapses, a result that no doubt would surprise most donees.[20]

Despite the similarity between the lapse of a general power of appointment and its exercise, in the situation where the donee intends for the appointive property to pass to the takers in default, the legislative history of section 2041 reveals that the House Bill provided that any power which lapsed during the life of the donee would not be deemed the exercise or release of a power of appointment.[21] Recog-

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[16] Treas. Reg. § 20.2041-3(d)(1)(1958).

[17] V AMERICAN LAW OF PROPERTY § 23.25 (1952).

[18] *Id.* at § 23.32.

[19] *See* note 6 *supra.*

[20] Treas. Reg. § 2514-3(a)(1958).

[21] H. R. REP. No. 327, 82nd Cong., 1st Sess., pt. 2, at 6-7 (1951).

nizing that this blanket exclusion was an invitation to tax avoidance, the Senate Committee inserted an amendment to the House Bill, which is now the language of section 2041(b)(2), to provide that, except for limited amounts of appointive property, the lapse of a general power of appointment constitutes a transfer of the appointive property by the donee to the takers in default for purposes of the federal estate and gift tax statutes, sections 2041 and 2514, respectively.[22]

A. *Federal Estate Tax—Section 2041*

The donee of a general power of appointment may desire to terminate his power in order to avoid having the appointive property included in his gross estate at his death. However, the exercise of this power by the donee will constitute a gift of the appointive property by him to the appointees for federal gift tax purposes under the general rule of section 2514(b).[23] Similarly, the release of this power by the donee will constitute a gift of the appointive property by him to the takers in default under the same general rule, primarily because a release of a general power of appointment in favor of the takers in default is indistinguishable from an exercise of the power in their favor.[24] Furthermore, subject only to the exception to the general rule for a five or five power, the lapse of a general power of appointment also constitutes a gift of the appointive property by the donee to the takers in default.[25]

The five or five power is an exception to the general rule that the lapse of a general power of appointment constitutes a transfer of the appointive property to the takers in default for federal estate tax purposes.[26] For example, if the donee of a general power of appointment lets his power to appoint the appointive property to himself lapse, the appointive property will be included in his gross estate on his death under section 2036, provided, of course, that he was a life beneficiary of the appointive property on the date his power lapsed.[27] If however, the donee has no interest in the appointive property other than his power of appointment, a lapse of his power, like the transfer of any property with no "strings" attached, completely divests the

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[22] S. REP. No. 382, 82nd Cong., 1st Sess., 7 (1951) *reprinted at* 1951 CODE CONG. & ADMIN. SERVICE 1535.

[23] IRC 1954.

[24] *Id.*

[25] IRC 1954, § 2514(e).

[26] IRC 1954, § 2041(b)(2).

[27] *See* note 6 *supra*.

owner of any interest in the property transferred, with the result that none of the property will be includable in his gross estate on his death.

Section 2041(b)(2), the exception to the general rule of section 2041(b), provides that the lapse of a general power of appointment constitutes a release for federal estate tax purposes only to the extent that the property, which could have been appointed by the power which lapsed, exceeded in value, at the time the power lapsed, the greater of (1) $5,000, or (2) 5 percent of the value, at the time the power lapsed, of the entire fund containing the property, which could have been appointed by the power which lapsed. Forgetting for a moment the 5 percent alternative, if the life beneficiary of a trust has a power to withdraw $5,000 each calendar year, and if he does not exercise this power in a particular year, he will not be deemed to have made a transfer for federal estate tax purposes. Absent this exception to the general rule of section 2041(a), the lapse would be treated as though the life beneficiary had made a transfer of property with a value of $5,000, while at the same time retaining an interest for life that would be includable in his gross estate for federal estate tax purposes upon his death under section 2036.

If the donee with a power to withdraw $5,000 each year dies during the year, the $5,000, or so much of it that has not been withdrawn by the donee in that year, will be includable in his gross estate under section 2041.[28] If, however, the donee only had the power to withdraw $5,000 during the month of December of each year, and he dies in the month of June, it would seem that the $5,000 that could have been withdrawn had he lived until the month of December in the year of his death would not be includable in his gross estate, because he did not have a power of appointment on the date of his death.[29]

B. Federal Gift Tax—Section 2514

Any transfer of appointive property by the donee of a general power of appointment for federal estate tax purposes under section 2041(b)(2) also constitutes a transfer for federal gift tax purposes under section 2514(e).[30] In other words, section 2514(e) is correlative to section 2041(b)(2). Specifically, section 2514(e) provides that the lapse of a general power of appointment constitutes a release for federal gift tax purposes only to the extent that the property, which

[28] A. CASNER 717.

[29] *Id.* at 717, note 57aa.

[30] IRC 1954.

could have been appointed by the general power of appointment that lapsed, exceeded in value, at the time the power lapsed, the greater of (1) $5,000 or (2) five percent of the value, at the time the power lapsed, of the entire fund containing the property subject to the lapsed power.[31]

III. THE FEDERAL INCOME TAX CONSEQUENCES OF THE FIVE OR FIVE POWER

A. *Simple Trust*

All of the ordinary income of a simple trust is taxable to the income beneficiary whether it is distributed to him or not, with the result that none of the ordinary income of a simple trust is taxable

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[31] The annual exclusion of $3000 for gifts made to any one donee during the calendar year does not apply to gifts of future interests. An example would be a gift to the donee in trust with respect to which the donee did not have the unrestricted right to the immediate possession and enjoyment of the property placed in trust. Not all trusts, however, confer only deferred benefits on the beneficiaries of the trust. For example, if property is placed in trust for A for life or until A terminates the trust, with the assets of the trust passing to A on termination, and A has the power to terminate the trust, A obviously has the immediate right to possess and enjoy the property placed in trust. In between these two extremes is the situation where the beneficiary only has the unrestricted right to possess and enjoy the income of the trust, in which case the income of the trust constitutes a gift of a present interest in the property placed in trust.

The status of a five or five power has not been completely resolved. As an illustration, assume that the donor creates a discretionary trust for his son until his son attains age 35 or dies, at which time the assets of the trust will be distributed to the son, or if his son dies before age 35, to the son's estate. Assume further that the father intends to transfer $5000 in this trust each year. Stopping here, the gift of $5,000 each year would constitute the gift of a future interest, in which case the annual exclusion of $3,000 would not be applicable. If, however, the son had a power to withdraw each annual contribution of $5,000 to the trust by his father in the same year that the contribution was made, a tenable argument could be made that the son has an unrestricted right either (1) to reduce each annual contribution of $5,000 to his immediate possession and enjoyment, or (2) to defer his possession and enjoyment of each annual contribution of $5,000 in accordance with the terms of the trust. In most cases, with one example being a trust in which a father transferred policies of insurance on his life, and, in effect, paid the annual premiums of $5,000 on these policies by transferring $5,000 each year to the trust, the son, knowing that the insurance coverage would be discontinued if the annual premiums were not paid by the trustee, probably would forego his power to withdraw the annual cash contributions made by his father. Consider also the case where the beneficiary of the life insurance is a minor. Finally, consider a situation where some adult, such as the minor's uncle, has the power to act on behalf of the minor, that is, exercise the minor's power of withdrawal on behalf of the minor.

either (1) to the trust, or (2) to the donee of a five or five power.[32] Thus, since a power of withdrawal in this situation would obviously relate to principal, a portion of any other income taxable to the trust, such as gains on the sale of capital assets, would be taxable to the donee of a five or five power under section 678.[33] The share of each item of income, deduction, or credit allocable to the donee of the five or five power as the owner of a portion of the trust is represented by a fraction the numerator of which is the amount subject to the control of the donee of the five or five power and the denominator of which is the fair market value of the trust's principal at the beginning of the taxable year of the trust in which the power was exercisable.[34] In most situations, this slight income tax cost to the donee of a five or five power should not preclude the use of the power in a simple trust.[35]

B. Complex Trust

As a general rule, only the income of a complex trust actually distributed is taxable to the beneficiaries of the trust, with any income not allocated to the beneficiaries being taxable to the trust.[36] If, however, another person has a power over income or principal, a portion of the ordinary income or income that usually would be taxable to the trust may be taxable to that person as the owner of a portion of the trust.[37]

(1) Power Over Only Ordinary Income

If a person has the power to withdraw ordinary income but none of the principal of a trust, for example, five percent of the income of

[32] IRC 1954, § 652(a); Treas. Reg. § 1.652(a)-1 (1956).

[33] Revenue Ruling 67-241, 1967-2 CUM. BULL. 225, correctly states the rule that the holder of a five or five power is treated as the owner of a portion of the trust under section 678, but it does not make it unequivocally clear that the wife in this ruling did not have any power of the *income* of the trust that was *required* to be distributed to the decedent's two sons. In other words, since she only had a power over the principal of the trust, only the items of income, deduction, and credit attributable to her portion of the *principal* of the trust should be included in computing her taxable income and credit. *See* Treas. Reg. § 1.671-3(b)(2) and (3) [last sentence] (1969).

[34] Treas. Reg. § 1.671-3(a)(3) (1969); A. CASNER 732. To compute the pro rata share of each item of income, deduction, and credit normally allocated to the holder of the five or five power, the fair market value of the assets of the trust at the *beginning* of the calendar year is important. However, the fair market value at the *end* of the calendar year is controlling for purposes of the five percent limitation. *See* note 48 *infra*.

[35] A. CASNER 732.

[36] IRC 1954, § 662(a); Treas. Reg. § 1.662(a)-3 (1956).

[37] Treas. Reg. § 1.671-3 (1969).

a trust, that person, as the owner of a portion of the ordinary income or the trust, is required to include this portion of the ordinary income in his gross income.[38] Any items of income allocable to principal, such as gains on the sale of capital assets, are not included in this portion, because a person with only a power over ordinary income would have no dominion and control over income allocable to principal.[39]

(2) Power Over Only Principal

As a general rule, a person with only a power to withdraw principal is not required, as owner of a portion of the trust, to include any ordinary income of the trust in his gross income.[40] For example, the grantor of a 12-year trust, with a reversionary interest in the principal of the trust, is required to include any gains on the sale of capital assets in his gross income under section 677(a)(2), because this income is accumulated for future distribution to him.[41] He, like the donee of a five or five power in a simple trust, would have no power over the ordinary income of the trust, provided the trust agreement required all of the ordinary income to be distributed to the income beneficiary of the 12-year trust.

(3) Power Over Income or Principal

If the trustee has the discretionary power to distribute or to accumulate income, a power of withdrawal would again obviously relate to principal.[42] In other words, the person with the power of withdrawal would have a right to withdraw a designated amount or percentage of the principal, while the trustee would have a discretionary power with respect to any distributions of income. However, since any ordinary income not distributed ordinarily would be allocated to principal in the same manner as gains on the sale of capital assets, the donee of a five or five power, as owner of a portion of the trust, is taxed not only on a portion of any income of the trust allocable to principal but on any ordinary income of the trust whether or not it is distributed even in the situation where all of the ordinary income is actually distributed to some other beneficiary.[43]

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[38] Treas. Reg. § 1.671-3(b)(1) (1969).

[39] *Id.*

[40] Treas. Reg. § 1.671-3(b)(2) (1969).

[41] *Id.*

[42] A. CASNER 732.

[43] *Id.*; Treas. Reg. § 1.671-3(b)(3) (1969). Any income, deduction, and credit attributable to the holder of a five or five power, as the owner of a portion of a trust, must be shown on a separate statement that is attached to the Form 1041, U.S. Fiduciary Income Tax Return, filed by the trust, with the result that the holder's share

As an illustration, assume that A has the power to withdraw $5,000 of principal each year from a discretionary $4,000 and capital gains allocable to principal of $6,000, that all of the ordinary income is distributed by the trustee to B, one of the discretionary beneficiaries of income, and that the value of the principal of the trust at the beginning of the year was $100,000. As a five-percent owner of the trust ($5,000 divided by $100,000), A must report $200 and $300 as ordinary income and capital gains respectively, despite the fact that all of the ordinary income was distributed by the trustee to B.[44] Thus, in a situation where distributions of income are discretionary with the trustee, the donee of a five or five power may want to withdraw enough money each year to pay the tax attributable to his share of the ordinary income and capital gains reportable as gross income by him under section 678.

C. *Grantor Trust*

If the donee of a general power of appointment who is a life beneficiary of a simple trust holding the appointive property lets his power lapse, he, as an income beneficiary of the simple trust, would continue to be taxed on the income of the trust actually or constructively distributed to him.[45] If, on the other hand, this donee were only a discretionary beneficiary of a trust, he, as a general rule, would only be taxed on the income of the trust actually distributed to him, with any undistributed income being taxable to the trust.[46] After the power lapsed, however, a tenable argument could be made that this donee, as the "owner" of the appointive property, became the grantor of the trust at the time the power lapsed, and, as grantor, would be taxable on all of the income of the trust under section 677(a)(1) whether he received it or not.[47]

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of any income, deduction, and credit are not subject to the provisions of §§ 661(a)(2) and 662 (a)(2). Rev. Rul. 67-241, 1967-2 CUM. BULL. 225; Treas. Reg. § 1.671-4 (1956). This same rule applies to the person who has a power of withdrawal even if that person is also a discretionary beneficiary of income. *See Points to Remember*, 22 TAX. LAW. 193, 195 (1968). For example, assume that B, and not A, in the example in the text had the power to withdraw $5,000 of the principal each year. The ordinary income of $200 and the capital gain of $300 would be taxable to B under section 678, and the balance of the ordinary income of $3,800 would be taxable to him under section 662. The balance of the capital gain of $5,700, however, would be taxable to the trust under § 641.

[44] *See* note 32 *supra*. The last sentence of § 1.671-3(b)(3) refers to a person treated as an owner under section 678.

[45] IRC 1954, § 652(a); Treas. Reg. § 1.652(a)-1 (1956).

[46] IRC 1954, § 662(a); Treas. Reg. § 1.662(a)-3 (1956).

[47] A. CASNER 732, n. 76. If the donee only had a five or five power, he might be

IV. CALCULATION OF THE FIVE PERCENT LIMITATION

The five percent limitation creates a number of administrative problems, primarily because the multiplicand - "the aggregate value . . . of the assets out of which . . . the exercise of the lapsed powers could have been satisfied" - must be determined.

A. *The Date The Fund Must Be Valued*

Section 2041(b)(2)(B) provides, that with respect to the lapse of powers during any calendar year, the value of the fund must be determined "at the time of such lapse."[48] As a general rule, a power lapses on the last day of each calendar year, specifically December 31. A power, however, could lapse at some other date during the calendar year, for example, (1) on the date of the death of the donee, (2) on the date the donee attained a specified age, or (3) on the date a trust terminated as the result of the expiration of its term. Thus, a trustee might have to refuse any requests by the donee for payment until the end of the calendar year in which a request for payment was made by the donee in order to be certain that the amount of the requests did not exceed the five percent limitation.[49]

B. *Assets With No Readily Ascertainable Value and Liabilities*

Other valuation problems could arise if some of the assets of the fund, for example, stock in a closely held corporation, did not have a readily ascertainable fair market value. Furthermore, if the fund has any liabilities such as trustee fees, legal or accounting costs, or unpaid taxes, the trustee may not be able to calculate the net value of the fund. This would be especially true if the fund had any contingent liabilities.[50]

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regarded as owner of 5 percent of the trust after the first calendar year in which his power lapsed, as owner of 10 percent after the second year, etc. It is being assumed that the consent of an adverse party is not required before distributions of income can be made to the grantor.

[48] Section 2514(e) omits the words "at the time of such lapse;" however, the regulations make it clear that the statute is concerned with "5 percent of the aggregate value at the time of the lapse of the assets out of which the exercise of the lapse power could be satisfied." Treas. Reg. § 25.2514-3(c)(4).

[49] A. CASNER 716 n.57a. If the donee was allowed to withdraw $7,000 in 1974, and the fair market value of the trust was only $100,000 on December 31, 1974, there would be no adverse gift or estate tax consequence, because the donee's five or five power did not lapse. However, the donee would owe the trust $2,000, because he only had the right to withdraw $5,000 and not $7,000.

[50] *Id.*

C. *Fractional Share of Specified Dollar Amount*

The five percent limitation might be regarded as either (1) a power to withdraw a fractional share of each asset in the fund or (2) a dollar figure represented by five percent times the value of the multiplicand.[51] Needless to say, a well-drafted power of appointment should unequivocally specify the donor's intent on this point. For example, assume a fund has 2,000 shares of stock with a basis of $100,000 and a fair market value of $200,000 and $200,000 in cash. Although the five percent limitation is $20,000, the question is whether this amount must be satisfied with either a fractional share of each asset in the fund, namely, 100 shares of stock with a value of $10,000 and $10,000 in cash, or any assets of the fund with a value of $20,000, for example, either $20,000 in cash or 200 shares of stock with a value of $20,000. If 200 shares of stock with a value of $20,000 and a basis of $10,000 are used by the fund in satisfaction of the dollar figure of $20,000, the fund may have a gain of $10,000, in which case the donee's basis in the stock received would be its value on the date of distribution of $100 a share, and not its basis of $50 a share in the hands of the fund.

D. *Fund Over Which Donee Has a Power*

The five percent limitation does not always relate to all of the assets of a trust. For example, a person may have the power to withdraw only five percent of the *income* of the trust, and hence none of the principal. The words "the assets out of which . . . the exercise of the lapsed powers could have been satisfied" were considered in Revenue Ruling 66-87.[52] In this ruling, the life beneficiary of a testamentary trust had the noncumulative right to withdraw the income of the trust each year. The question was whether, in calculating the amount of the five percent limitation, the multiplicand was either (1) the amount of the trust income, or (2) the value of the principal of the trust. In concluding that the multiplicand was the trust income and not the trust principal, the ruling indicated that the donee's power in the situation could only be satisfied out of assets belonging to the income of the trust.

This same point was litigated in *Fish v. United States.*[53] In *Fish,* the donor's wife had "the right in any calendar year to demand payment to her of all or any part of the net income of the trust for that

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[51] *Id.*

[52] 1966-1 CUM. BULL. 217.

[53] 432 F.2d 1278 (9th Cir. 1970).

year,"[54] with any income not withdrawn being added to principal. The Commissioner took the position that income not withdrawn by the wife for the years 1955 through 1959 of $32,337.97, $11,153.81, $17,815.18, $26,954.13, and $52,784.27, respectively, less $25,000 (an exclusion of $5,000 for each of five years) was includable in her gross estate under section 2036; and further reasoned that these annual additions to the principal of the testamentary trust created by the donor in his will increased the income of the trust subject to the wife's power of withdrawal. The administrator of her estate, however, contended that the exclusion was not $5,000 a year but five percent times the value of all of the assets of the trust and not just its income.

The district court,[55] after reviewing the legislative history of 2041(b)(2), concluded that the five percent limitation applied to the "fund in which the lapsed power existed," and that the "fund" in this case was the income of the trust, because this was the only property on which the wife had a power of appointment. On appeal, the district court was upheld with the following comment:

> While the language of Section 2041(b)(2)(B), like much of the statutory tax law, is hardly a model of precision and clarity on the point, we are satisfied from a reading of the statute together with its legislative history that the applicable basis for computation of the allowable exemption is the trust or fund in which the lapsed power existed. The District Court correctly determined that the power of appointment in the instant case existed only with respect to the trust income, and properly allowed an exemption of $5,000 [$5,000 exceeded five percent of the income of the trust for each of the five years in question] for each year in question.[56]

E. Donee With More Than One Power of Withdrawal

Neither the Code nor the regulations discuss the treatment of a person with two powers of withdrawal. However, both section 2041(b)(2) and section 2514(e) refer to the lapse of *powers*, thereby indicating that all powers which lapse in one calendar year must be aggregated to determine whether or not the person with more than one power exceeds the five percent limitation.[57] For example, assume that a person has the power to withdraw $5,000 from trust A and

[54] *Id.* at 1279.
[55] 291 F. Supp. 59, 62 (D. Ore. 1969).
[56] 432 F.2d 1278, 1281 (9th Cir. 1970).
[57] A. CASNER 717 n.57a.

$5,000 from trust B, and he lets both powers lapse. If five percent of the aggregate value of the assets of both trusts equals or exceeds $10,000, the five percent limitation apparently saves both lapses from being a transfer for federal estate and gift tax purposes. If, however, $10,000 exceeds the five percent of the aggregate value of the assets of both trusts, the donee has apparently made a gift with a retained life interest of the excess.

V. CONCLUSION

The power of appointment "has proved extremely useful, though somewhat plagued by logical anomalies resulting from the manner of its birth."[58] Although "a page of history is worth a book of logic,"[59] today's predominantly public-law-minded faculties show little inclination to be generous in allotting time to, and today's crowded curriculum in law school leaves little time for "old-fashioned subjects like property."[60] This puts the draftsmen of wills and trusts who are called upon to give "expert" advice relating to future interests such as the exercise, release, and lapse of powers of appointment and the enigmatic rule against perpetuities,[61] at a big disadvantage since they will find little time to, and perhaps show only a slight propensity for, mastering medieval law. Of course, a thorough understanding of the five or five power does not require a special course in future interests, but it does command more than a speaking acquaintance with sections 2041 and 2514. Thus, in conclusion, a simple power to withdraw

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[58] P. MECHEM, FUTURE INTERESTS 231 (1958).

[59] New York Trust Co. v. Eisner, 256 U.S. 345, 349 (1921).

[60] P. MECHEM, FUTURE INTERESTS ix (1958).

[61] Where an appointment is made under a special power or a general testamentary power, the appointment is read back into the instrument creating the power (as if the donee were filling in blanks in the donor's instrument, and the period of perpetuities is computed from the date the power was *created*). Leach, *Perpetuities In a Nutshell*, 51 HARV. L. REV. 638, 653 (1938). As an illustration, assume T bequests a fund in trust for A for life, remainder to such issue of A as A shall appoint by will. A appoints to B, a child of his who was not living on the date of T's death, for life, remainder to B's children. Since B was not a life in being on the date of T's death, the date the power was created, the gift to B's children would vest too remotely, namely, later than twenty-one years after some life in being at the creation of the interest.

In Delaware, however, the period of perpetuities with respect to special powers is computed from the date the power is *exercised*, with the result that property can be tied up in a family *forever*. *Id.* The assets of the trust would still be included in A's gross estate under § 2041(a)(3), because another power of appointment was created by A which under Delaware law could be validly exercised so as to postpone vesting of the remainder interests in B's children for a "period ascertainable without regard to the date of the creation of the first power."

$5,000 or less each year raises only a few minor tax problems, but the incorporation of a five or five power into a will or trust takes more attentiveness and time than most draftsmen have to spare.

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