

POWERS OF APPOINTMENT

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In the last Moss & Barnett newsletter, we wrote about disclaimers. Some of the questions we received in response to that article led to discussions of a different estate planning technique known as a “power of appointment.”

A person writing a will or trust can give his or her beneficiaries a power of appointment, which enables them to direct where their share of the estate or trust goes at their death. A power of appointment provides flexibility for transferring property to children and grandchildren.

What Is A Power of Appointment?

A power of appointment grants authority to designate the recipients of property held in an estate or trust. A power of appointment may be given to a beneficiary to permit that beneficiary to direct the ultimate distribution of his or her share.

There are two types of powers of appointment: a limited power of appointment and a general power of appointment. A limited power of appointment permits the beneficiary to allocate his or her share of the estate or trust among certain classes of potential recipients, such as the testator’s descendants or charitable organizations, but not to the beneficiary, the beneficiary’s estate, or creditors of the beneficiary or the estate thereof. A general power of appointment is a broad power that enables the beneficiary to allocate all or part of his or her share of the estate or trust among any individuals or organizations selected by the beneficiary.

How Can A Power of Appointment Be Used to Create Flexibility?

A client creating a will or trust today cannot predict his or her family’s economic or personal situation 30 years from now. A power of appointment provides flexibility by permitting the holder of the power to alter the distribution plan in a will or trust to accommodate changed family situations. The person holding the power of appointment has the opportunity to reevaluate the family situation to determine the best possible outcome for the assets. The following examples illustrate powers of appointment.

Example 1. A’s will creates a trust for the benefit of his spouse after A’s death. A grants his spouse a limited power of appointment to appoint the assets remaining in the trust at her death among A’s issue (*i.e.*, children, grandchildren, great-grandchildren, etc.) or trusts for their benefit as she determines. If A’s surviving spouse does not exercise this power, the assets remaining in the trust will be distributed outright in equal shares to A’s children. A’s son has developed a substance abuse problem. A’s spouse exercises her limited power of appointment to appoint the share for A’s son to a trust for his benefit rather than leaving the funds to him outright.

Example 2. B’s will creates a trust for the benefit of her daughter after her death. B grants her daughter a general power of appointment to appoint the assets remaining in the daughter’s trust in any manner. Over the years, daughter accumulates substantial wealth and in various ways she provides adequately for her children. Daughter then exercises the general power of appointment to appoint the assets in the trust to charities of the daughter’s choice.

Note that giving a person a power of appointment implies a great degree of trust in that person’s judgment. As a general power of appointment places no limits on the power holder, limited powers of appointment are often used instead. In addition, limited powers of appointment in most circumstances lead to more favorable tax treatment.

Tax Consequences

General powers of appointment and limited powers of appointment have very different tax consequences. The mere possession of a general power of appointment over trust property will cause the power holder to be subject to gift tax or estate tax on that property whether or not the general power of appointment is exercised. In most cases, the possession of a limited power of appointment does not subject the power holder to gift or estate tax. To be sure that a power is a limited power rather than a general power, specific wording must be used to comply with Internal Revenue Code requirements.

Thus, in Example 2 above, the existence of a general power of appointment will cause the assets in the trust for daughter’s benefit to be subject to estate tax at daughter’s death. By exercising the general power of appointment in favor of one or more charitable organizations, daughter’s estate receives a charitable deduction for the assets passing to charity.

Conclusion

Powers of appointment can be an effective and cost-efficient tool to add flexibility to long-term trusts. If you would like to learn more about powers of appointment and whether they could be an appropriate addition to your estate plan, please contact your attorney at Moss & Barnett.



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