

Powers of Appointment: Planning for the Future Even After You are Gone

By Robert K. Schweitzer, Esquire
August 2017

Frequently, clients are reluctant to finalize their estate plans because they want to plan for all contingencies that could happen to their beneficiaries. For example, some clients want to provide for the benefit of their children during their lives, but upon the death of their children would like the remaining inheritance to go to their grandchildren as opposed to their child's spouse so that their wealth can stay within family lines.

A solution to the above problem is to include a power of appointment provision in the client's last will and testament or trust. A power of appointment permits the holder of the power (in the above scenario, the children) to alter the distribution plan to adjust for changes in family situations after their parents are gone to determine the best possible use for their inherited assets. The balance of this article describes power of appointment provisions in more detail.

What is a power of appointment?

A person creating a trust or a last will and testament (the "donor") can give his or her beneficiary (the "power holder") a power of appointment, which in turn enables the power holder to direct where the beneficiary's share of the trust or estate should be distributed at the power holder's death (the "appointees").

What are the different types powers of appointment?

There are two types of powers of appointment: (1) a general power of appointment and (2) a special power of appointment.

General power of appointment

A general power of appointment is a broad power. It permits the power holder to appoint all, or a portion, of his or her interest in inherited property among any individuals or organizations (including the power holder's estate, creditors or creditors of the power holder's estate) as selected by the power holder—either during his or her life or upon death.

Example: Mother creates a lifetime trust for her only son that will be funded upon her death. Mother provides in the trust that her son has a general power to appoint the assets remaining in the son's trust at the time of his death to any person or organization. The son is a highly

successful executive, accumulates substantial wealth during his lifetime, never marries and has no children. The son exercises his general power of appointment to appoint his trust assets to a charitable organization. The son's estate receives a charitable deduction for the assets passing to charity and thus lowers his estate's death tax exposure.

Special power of appointment

A Special Power of Appointment (often times also referred to as a "limited power of appointment") permits the power holder to distribute his or her share of the estate or trust property among certain defined class of beneficiaries (other than the beneficiary's estate or creditors, or creditors of such beneficiary's estate).

Example: Same facts as above, but now assume the son is married and has two children. Mother desires that the son's trust stay within the family lines for the benefit of her grandchildren because she fears that with the divorce rate being fifty (50%) percent in the U.S., her son and his wife may divorce after she (mother) is gone. Mother therefore grants her son the right only to appoint the remaining trust assets at the time of his death to his descendants (children and great grandchildren) pursuant to such trust terms and conditions as the son may direct in his last will and testament or trust. The son appoints his inheritance to his children "in further trust" for their health, education, maintenance and support for their lifetimes. By doing so, the son protects the assets from his children's creditors and their future spouses. At the same time, the son's children can access the trust funds for their health, education, maintenance and support during their lifetimes. The inherited assets were part of mother's estate and not included in son's estate thus permitting the inherited assets to pass free of death taxes.

What are the tax consequences?

General and special powers of appointment have very different tax consequences. The possession of a general power of appointment over trust property will, in most cases, 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. Conversely, special powers of appointment are not included in the power holder's estate in most instances. Therefore, great care must be taken in drafting power of appointment provisions.

How do powers of appointment permit you to plan for the future?

No one can predict what your family circumstances will be next year, let alone in the decades to come. Granting your estate or trust beneficiaries the power to appoint their inheritance permits your beneficiaries to make rational, fact based decisions to plan for unforeseen contingencies in their lives.