

ESTATE PLANNING: UTILIZING POWERS OF APPOINTMENT

Clients should consider updating their estate plan at least every five years or so. There could be changes in regulations and laws that affect taxation and estate assets which could require changes and amendments to the estate plan. Or, there could be changes in the family and personal situation (such as children and/or grandchildren being born, the disability or death of a family member, a beneficiary who develops other personal or financial problems or significant growth in wealth) which requires changes and amendments to the estate plan. Therefore, it is critical to at least consider implementing an estate plan with some flexibility that could address these changes if an estate plan is unable to be updated at regular intervals. Other articles on this website discuss some examples of flexibility that can be used within an estate plan such as disclaimers, portability and using revocable trusts.

Using a “power of appointment” allows for changes in the stated distributions that were originally drafted within the Will or trust document. Generally, a power of appointment is a power granted to someone called the “donee” to appoint to persons who are to receive a distribution from an estate or trust after the death of the creator of the Will or trust, or, possibly after the death of the donee. Often, the donee is able to change who will receive distributions from an estate or trust by exercising the power of appointment, or, how the beneficiary will receive the distribution such as outright or in further trust.

There are basically two types of powers of appointment: general and limited (or sometimes called special). A general power of appointment allows the donee to direct property to be distributed to the donee, the donee’s creditors, donee’s estate or the creditors of the donee’s estate. A limited power of appointment allows the donee to direct property to be distributed to anyone *other than* the donee the donee’s creditors, the donee’s estate or the creditors of the donee’s estate. Often, limited powers of appointment are limited by clients to their children and other lineal descendants.

The testator of the Will or the creator of the trust can grant powers of appointment within these documents to donees, who could be beneficiaries or other third parties such as a trust protector (trust protectors are usually non fiduciary/non trustee individuals indicated within trusts who are given the authority to make certain changes to trust terms such as removing and replacing trustees are being able to change trust distributions through powers of appointment). The Will or trust document creating the power usually instructs the donee as to how the power of appointment shall be exercised, which could be at any time or via the donee’s Will at the death of the donee by making specific reference to the original document that created the power of appointment. Therefore, flexibility for altering distributions that might be warranted due to some of the future unseen circumstances described if desired by my clients.

My clients sometime use powers of appointment for income tax or estate tax planning purposes. A general power of appointment granted to a donee within an irrevocable trust causes the donee who has been granted the power to have assets subject to the power to be

included in their gross estate subject to estate taxation. But, this could be important if the donee does not have a larger gross estate that will pay estate tax and it is desirable to be able to have those assets be adjusted or stepped up in value as of the donee's death for limitation of capital gain purposes (assets within irrevocable trusts are generally not increased in value after transfer into an irrevocable trust). A limited power of appointment granted to a donee will not be included within the donee's gross estate for estate tax purposes and this is often desirable when trying to limit the donee's gross estate value but allowing for flexibility for changing distribution terms in Wills and trusts. Sometimes powers of appointment are used in asset protection planning by including certain powers within trusts designed to minimize exposure to creditors of the trust creator.