

## A What?

July 2010 from James M. Kane, Attorney

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Some lawyers too lightly brush over the topic of powers of appointment when preparing trusts for clients. Clients end up with not much more than an 'a what?' recollection about this important topic.

Thus, this subject is worthy of the attention I am giving it in this newsletter.

Powers of appointment are defined written provisions that are part of the trust document. Any person or persons can be named as holding these powers, including the trust beneficiaries themselves.

Whether you include these powers of appointment within the written provisions of your trust document is a very important option.

As a starting point, powers of appointment are relevant only when you use trusts. These powers are not available if your property passes outright to your beneficiaries rather than in trust.

Powers of appointment give the power holder flexibility for unforeseen future events, such as responding to a change in the relative financial needs of the trust beneficiaries, or diverting property away from a nasty divorce situation, or redirecting the trust property for even greater asset protection.

There are also many estate, gift and income tax planning features potentially available with the use of powers of appointment, not available with an outright distribution.

### Examples of Using Powers of Appointment

#### Example 1 –

The surviving spouse in this example has the power of appointment after the first spouse's death. The first spouse's property is held in trust for the surviving spouse [the surviving spouse is also the trustee]. The trust language provides that the income and principal is to be used for the needs of the surviving spouse, with the remaining trust property at the surviving spouse's death to be divided equally for the children. There are two children in this example.

The surviving spouse's power of appointment in this example gives her additional flexibility – if necessary – later to change the equal division to the children after the surviving spouse's death. Keep in mind this is the equal division of the first-to-die spouse's trust. [Individuals other than children, such as nephews and nieces, can be included in the defined recipient group.]

Thus, assume one child, "Child A", develops significant health problems and the other child, "Child B", is in good health and financially well-off.

The surviving spouse (their mother) may choose to exercise her power of appointment over the first spouse's trust property by directing that instead of the equal division under the terms of the trust ultimately to her two children, alternatively  $\frac{3}{4}$  of the trust property will be held in a special needs medical trust for Child A,

with any remaining trust property in this special needs trust passing to Child B upon Child A's death. The other ¼ in this example remains for Child B.

Or, Child A might end up later facing a very costly divorce. The surviving spouse (the mother of Child A) may as a result exercise her power of appointment to put into place much stricter trust provisions for Child A for his ½ share of the property. The stricter provisions can help insulate the trust property from the divorce action. Thus, the surviving spouse would in this example be exercising her power of appointment "in further trust" as to Child A's share of the trust property.

Example 2 --

What if a grandchild ends up with a severe drug addiction problem? The client's child (the parent of the grandchild) can later, if necessary, exercise a power of appointment so as to end or decrease that drug-addicted grandchild's trust property or may exercise the power to carve out another subtrust (in further trust) for the grandchild that is even more strict and limited in dollar amount.

Example 3 --

Another frequent use of a power of appointment is to enable a child (or other beneficiaries) to use the power to benefit their spouse for a portion or all of the trust property (trust income or principal), if that child so chooses. This can be particularly important in marriages where the child and his or her spouse end up having no children.

Except with use of these powers of appointment, the children's spouses in these situations are otherwise frequently not included as trust beneficiaries in a client's core estate planning documents. Thus, these powers of appointment are very important in giving a client the option -- if the power holder later so chooses -- to enable the trust beneficiaries' spouses to the benefit from the trust.

### You Define the Scope of the Powers of Appointment

You define by the written terms of your trust document: How the power can be applied (such as in further trust or only as to the income of the trust, etc.); How much of the trust can be affected by the power of appointment (such as all or a percentage or dollar amount of the trust property); And who can be brought within the benefits of the trust (such as a child's spouse).

These powers in most cases are designed so that they cannot be triggered until after your death. The power holder does not have to trigger (or exercise) the power of appointment. The powers can sit unused if necessary.

Also most typically, the power holder cannot exercise the power to increase his or her own share of the trust property. This is why the power is more accurately called a limited power of appointment [as compared to a general power of appointment. General means the power holder can increase his or her own share to the exclusion of other trust beneficiaries].

There are also many estate, gift and income tax planning features that are potentially available with the use of powers of appointment compared to an outright distribution.

### The Power to Disappoint

Finally, some commentators refer to a power of appointment also as a 'power to disappoint'. It can, therefore, be used to help keep trust beneficiaries in line. For example, a surviving parent who holds a power of appointment can wield a great deal of power over the actions of her children, thus keeping them aware, if necessary, that the parent's power can be used to disappoint a child.

This human factor is realistic; and clients need to be aware of its potential ramifications when considering the use and design of powers of appointment.

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