

CHAPTER NINE – Power of Appointment Planning

Defining the “power of appointment” (P/A) – a state property law concept.

Power is held by a person other than the trust grantor – identified as the “donee” of the power.

Note: (1) Who are the possible appointees? or, (2) The “takers in default” of the exercise of the power of appointment.

Cf., a general P/A vs. a special P/A (this is state property law terminology; cf., non-general P/A).

Cf., an exclusive P/A vs. a non-exclusive P/A.

What are the possible rights of creditors? P.4.

Potential Federal Tax Issues

Federal estate tax - §2041

Federal gift tax - §2514 (& §2511)

Federal income tax - §678

Federal generation skipping transfer tax –
§ 2601 et. seq.

Federal Estate Tax Inclusion when P/A?

Code §2041(a)(2) provides for inclusion in the gross estate of the property subject to a “general” P/A held by the decedent at death.

Defining a general P/A – see TAM 200014002 (p.7): Decedent as co-trustee and life beneficiary; trustee could distribute income for “comfort and support” and discretion re corpus distributions. Are these powers too broad?

But: What if state law prohibits the exercise of power to distribute corpus to herself (trustee).

Consequently, here no general P/A held by the co-trustee-beneficiary.

What if ambiguity exists re existence of gen. P/A?

P.9. Possible judicial construction of the power as not being a “general” P/A (for state law purposes) but a “special” power?

Possible reduction of a power from “general” to “non-general”:

- 1) Through judicial reformation**
- 2) As permitted under the trust instrument?**

Consider the application of § 2514 (gift tax)?

Trustee Replacement Authority – p.10

Remember Estate of Wall and Rev. Rul. 95-58 re (non) inclusion when transfers to trust (& required independent corporate substitute).

PLR 200024007, p. 10 - see Article Tenth (p. 11) – re no authority of the trustee to appoint to himself.

Note Spouse as a member of a Committee to identify a replacement trustee.

Held: not holding a general P/A if serving as a Committee member at death.

Estate Tax Apportionment

p.14

Code §2207 mandates a proportionate allocation of the federal estate tax cost attributable to property included when the decedent at death holds a general P/A.

P/A assets are not (ordinarily) in the probate estate but are held in a separate trust.

How negate the applicability of this tax apportionment rule, if desired? See Code §2207 providing for allocation “unless the decedent directs otherwise in his will ...”

“Ascerttainable Standard”

Exception

p.14

§2041(b)(1)(A) – exception from P/A estate tax inclusion when the power over property is limited by an “ascertainable standard.”

Rev. Rul. 78-398, p. 15 – the income beneficiary, as the sole trustee, has a power to apply corpus for beneficiary’s (i.e., his/her own) benefit.

But – limited to “maintenance and medical care” and determined to be an “ascertainable standard.” Not a general P/A.

See Notice 2008-63 (p. 16) re “private trust company” (PTC) as the trustee – not alone causing estate tax inclusion.

What is an “Ascertainable Standard”?

See Reg. §20.2041-1(c)(2).

Rev. Rul. 77-60, p.16 – trust provides a power to invade corpus “to continue the donee’s accustomed standard of living.”

The test is the “measure of control” over the property (p.17); i.e., is control restricted by “definite bounds”? Not here and, therefore, not an “ascertainable standard.”

Requirement of acting in “good faith” is not relevant for this determination.

Vissering case & state law concepts p.18

Did the decedent possess a general P/A?

- Trust agreement created under Florida law.**
- Resident in New Mexico at time of death.**
- Decedent co-trustee of deceased spouse's trust.**
- Decedent mentally incapacitated.**
- Standard (?) for distribution: “continued comfort, support, maintenance, or education” of the beneficiary, p. 20. Cf., HSEM.**
- State law (Florida) determines the scope of this power. Use “Certification”? P.26**
- Remember the Bosch case (noted at p.22) - controlled by state property/trust law.**

State law concepts

Texas statute p.18, Fn 11

Texas Property Code § 113.029(b)(1) that –
unless trust terms expressly require otherwise
- The trustee’s power to make a discretionary distribution to the trustee is subject to a health, education, support or maintenance “ascertainable standard” (i.e., within the meaning of Code §2041(b)(1)(A); and,
- Trustee may not exercise power to make a discretionary distribution to satisfy the trustee’s legal obligation to support.

Adverse Party Exception

p. 27

Code §2041(b)(1)(c)(ii) – not a general P/A where exercise only with another person having a substantial adverse interest in the property.

Note the Vissering case – the bank was not adverse, p.20. Why?

Rev. Rul. 77-158, p. 28 – here three trustees could distribute, including to themselves & therefore, treated as each owning a 1/3 interest – majority vote, unanimity was not required.

Cf., “distribution committee” issues, p. 29; have adverse interests for gift tax purposes.

The “5 or 5” Power Exception

p.29

Basic rules: (1) a “release” of a power is a “transfer,” and (2) a “lapse” of a power is a “release” (which, per (1) is, therefore, a transfer for estate tax purposes).

What is impact of a release? Example: A is life tenant of trust; A has power to withdraw from trust but does not do so & assets remain in trust; A dies when still entitled to income; A is treated as the trust grantor of released portion & income interest & §2036(a)(1) applies.

The “5 or 5” Power Exception

p.30

“De minimis” exception to this §2036(a)(1) treatment?

See Code §2041(b)(2) – a lapse is treated as a release & treated as a transfer (for Code §2036-2038 purposes) only if the property value for which the lapse occurs is greater than \$5,000 or 5% of the trust corpus (e.g., \$1 million trust corpus enables a \$50,000 lapse power in this context).

Rev. Rul. 79-373

Estate tax?

p.31

Life insurance & withdrawal powers -
includible in gross estate? Settlement options:
income & noncumulative withdrawal right.

Not includible for prior lapsed powers – since
not exceeding the “5,000 or 5%” limit (and,
therefore, no §2036 gross estate inclusion).

But, inclusion of the amount subject to the
withdrawal power at the time of death.

Kurz case re sequencing powers p.32

Spouse has rights under two trusts: (1) marital trust – she could withdraw all; and (2) family trust – she could withdraw 5% - if the marital trust is first exhausted.

Was the 5% of the family trust includible in her estate – even though the marital trust was not exhausted? Yes, she could have exhausted the marital trust; therefore, can not sequence multiple trusts to frustrate inclusion for the 5% amount.

“5 or 5” Power & Annual Donee Exclusion p.35

Code §2514(b) - exercise or release of a general P/A is a gift.

Code §2514(e) – exception for “5 or 5” power lapse.

Only one lapse per year – whether multiple gifts or multiple trusts.

Amount transferred – reduced by income interest component.

Code §2514(e) - & annual donee exclusion?

Rev. Rul 85-88

Section 2514(e) p.36

Successive lapses of multiple non-cumulative powers to withdraw.

What is the amount of the taxable gift resulting from the lapse?

Holding: Only one “5 or 5” exemption under Section 2514(e) for all lapses of powers of appointment in a single year.

See Procter case, p. 38, re “hanging powers” & treated as contrary to public policy

Income Tax Treatment when P/A - §678 P.38

The holder of the power is treated as the owner of the trust property (and, therefore, the trust income) for federal income tax purposes.

Note: Rev. Rul. 67-241, p. 39

PLR 200022035, p.40: the donee of the power who does not exercise is treated as making a partial release and treated as a partial owner of the trust for income tax purposes. (Sections 677 & 678(a)(2))

Donee's E&G Tax Considerations

p.42

Rev. Rul. 79-327, p. 42, a gift is completed under Code §2511 – when

- (1) An exercise of a special power of appointment occurs, and**
- (2) The individual possessed an income interest in the trust property for life (thereby terminating this life interest).**

PLR 201550011

p. 45

Comprehensive example of trust structuring.

Power of Appointment Committee

Objectives:

- 1) No Section 671 inclusion**
- 2) No completed gift by members of committee.**

See multiple PLRs noted at p. 55.

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