

What is a Power of Appointment?

A power of appointment with respect to property exists when an individual (the “holder” or “possessor”) has the legal right to determine who will become the beneficial owner of the property. Powers of appointment are often used in order to provide flexibility in an estate plan, particularly when there is some uncertainty as to whether a potential beneficiary will merit receiving a distribution at some future time. In such a case, a person trusted by the donor of the property is given a power of appointment.

For example, Dad establishes a testamentary trust upon his death. The income of the trust is to be paid to Mom during her lifetime and, upon her death, the remainder is to go to their children, Son and Daughter, in equal shares. However, because Dad had concerns about the future needs and levels of responsibility of Son and Daughter, his trust provides that Mom has the power to vary the distribution of the remainder interest between Son and Daughter as Mom deems appropriate. Mom is able to exercise this power pursuant to a written instrument executed before her death. This power in Mom to decide how the remainder should be divided between Son and Daughter is a power of appointment.

Powers of appointment can be structured in a wide variety of ways. For example, the power of appointment might be granted for only a limited period of time (*e.g.*, for 10 years). The power of appointment might be limited to only a specified class of potential beneficiaries (*e.g.*, Son and Daughter in the example), or it might be unlimited, allowing the holder to appoint the property to any person.

For transfer tax purposes, it is important to distinguish between “general” powers of appointment and “nongeneral” powers of appointment. In general, a power is a general power of appointment if it allows the power holder to appoint the property to herself, her estate, her creditors, or the creditors of her estate, unless such power is limited by an ascertainable standard relating to the health, education, support, or maintenance of the holder. *See* Code §§ 2514(c)(1) (gift tax); 2041(b)(1)(A) (estate tax).

A power is a nongeneral power if it is not exercisable in favor of the holder, her estate, her creditors, or the creditors of her estate, or it is otherwise excluded from the definition of “general power of appointment” under Code § 2514(c) (or, with respect to the estate tax, Code § 2041(b)). In the above example, the power is a nongeneral power of appointment, because Mom can only appoint the property to Son or Daughter, not to herself, her estate, her creditors, or the creditors of her estate.